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STATE HISTORY, LEGAL ADAPTABILITY AND FINANCIAL DEVELOPMENT

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Abstract: A country's cumulative experience with statehood influences its ability to consolidate power and create a capable bureaucracy. Longer statehood experience gives countries more time to adapt their laws to local needs, provided the legal system is adaptable. We find that, relative to British common law countries with the most flexible laws, German and Scandinavian civil law countries initially exhibit lower financial development. However, as their history of statehood grows longer, financial development improves in countries with adaptable laws such as the German and Scandinavian civil law countries. This is not the case in French civil law countries with more rigid legal systems. Our results mainly show no or at most a weakly negative effect of French civil law legal origin on financial development. We also explore how changes in stock market development over time, financial integration, and financial crisis are impacted by statehood experience, legal origins and their interaction.

Keywords: State antiquity; state capacity; legal origins; colonization; financial development; financial integration; financial crisis.

JEL classification: G20; K20; N20; O16.

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1. Introduction

The literature explaining the pattern of modern financial development across countries emphasizes legal traditions and their adaptability (La Porta et al., 1997, 1998, 2008; Beck et al., 2003a; Malmendier, 2009), fiscal and legal capabilities (Besley and Persson, 2009; Becerra et al., 2012), existing geographic and disease conditions at the time of colonization (Acemoglu et al., 2001, 2002; Beck et al., 2003b; Oto-Peralías and Romero-Ávila, 2014), political influences (Rajan and Zingales, 2003), the history of statehood and financial system development (Fohlin, 2012; Ang, 2013a), the power of creditors (Aghion and Bolton, 1992), and information on credit (Stiglitz and Weiss, 1981; Djankov et al., 2007).

In this paper, we seek to shed further empirical light on how the adaptability of legal systems influences financial development. We argue that adaptation takes time; longer statehood experience changes the ways in which legal origin impacts financial development, provided that the legal regime is sufficiently adaptable. Two opposing hypotheses can be formulated. On the one hand, the effect of statehood experience may be favorable to financial development if policymakers are benevolent. On the other hand, a longer state history could worsen financial outcomes if it leads to the accumulation of power by entrenched politicians and interest groups whose focus is purely on private enrichment (cf. Rajan and Zingales, 2003).

Legal traditions differ in their emphasis on private property rights versus the power of the state (Beck et al., 2003b; La Porta et al., 2008), as well as their adaptability (Stone, 1936; Hayek, 1960; Posner, 1973; Beck et al., 2003a; Malmendier, 2009).¹ La Porta et al. (2008) present a Legal Origins Theory (LOT) which argues that British common law strongly protects private property rights, while French and German civil law was created to promote state power. Financial development is enhanced when the legal system adapts efficiently to the evolving contracting needs in the economy (Merryman, 1985; Beck et al., 2003a). Financial development therefore progresses faster under common law systems than under civil law regimes, according to La Porta et al. (1997, 1998, 2008) and Beck et al. (2003b). However, the adaptability and flexibility of legal systems is still debated in the literature (see, for example, Lamoreaux and

¹ A sizeable literature has investigated the implications of common law and civil law for modern economic and legal institutions, e.g., for the degree of judicial independence; formalism of judicial procedures; securities, company, and bankruptcy laws; and government ownership of banks (La Porta et al., 1997, 1998, 2008; Djankov et al., 2007). These institutions have important implications for economic outcomes, e.g., the share of the unofficial economy, property rights, stock market development, private credit, and corruption.

Rosenthal, 2005). Our empirical work provides new evidence on the role of the adaptability of different legal systems and the consequences of this adaptability for financial development.

In particular, British common law builds on jurisprudence. Judges have broad interpretation powers and continuously mould and create new laws as gaps emerge between financial system needs and the ability of the legal apparatus to address those needs. Facts and decisions in concrete new cases are crucial parts of the process, rather than a strict adherence to codified law (Posner, 1973). This increases the ability of the common law legal system to change inefficient laws as they are repeatedly challenged in court (Rubin, 1977, 1982; Priest, 1977; Bailey and Rubin, 1994; Levine 2005; Ponzetto and Fernandez, 2008). French civil law, on the other hand, does not allow for jurisprudence but instead uses comprehensive and rigid legal codes that do not evolve with the existing conditions of the economy (Beck et al., 2003a), thus becoming increasingly outmoded. The French commercial code of 1807 was not substantially revised until the 1960s, for example (Lemerrier, 2003; quoted by Lamoreaux and Rosenthal, 2005).²

The French revolution aimed to eliminate jurisprudence, and under Napoleon's legal doctrine, judges were seen as clerks who simply applied existing codes to each case. Merryman (1996) argues that while in France the system found ways to circumvent the worst aspects of the civil codes, the colonial recipients of the French civil law legal system were severely hampered by its rigidity. The French colonizers imposed their codes strictly. They disregarded any tensions with local laws, in contrast to the British approach (Zweigert and Kötz, 1998). Such inconsistencies reduced the usefulness and efficiency of the transferred law. The French colonizers also transferred a negative view of jurisprudence, judges, and judicial discretion. Moreover, since judges essentially had clerical duties, the associated remuneration and prestige tended to cause the best and brightest to seek out other professions. Finally, French legal culture restricts open conflicts between judges discussing how the law applies to novel circumstances (Dawson, 1968).

The German civil law codification system is positioned between British common law and French civil law (Beck et al., 2003a). It is more responsive to changing needs than French civil law and allows for jurisprudence. Unlike the French, German courts worked with university law

² However, we note that Roman law, a predecessor to civil law, was highly flexible as it was created by using case-based law (see Malmendier, 2009).

faculties and made public their deliberations over conflicting statutes, rationalized decisions made, and new legal questions. Germany therefore produced a more dynamic and flexible form of codes with inbuilt jurisprudence. Scandinavian law is commonly classified as part of the civil law family, but is not as close a relative to Roman law as its French and German cousins (Zweigert and Kötz, 1998). In this paper, we pay particular attention to the effects of German and Scandinavian law since these systems have a degree of built-in capacity for adaptability. However, their ability to adjust to changing circumstances is lower than that of common law.³ German and Scandinavian legal origins have often been neglected in the literature on financial development, potentially missing some valuable insights regarding the effects of the adaptability of law (see Beck et al., 2003a).

The creation of nation states is a highly important form of institutional development. It has led to multiple fundamental and far-reaching changes in human history. The literature argues that long-term historical processes, including the use of money as a medium of exchange, taxation, and experience with government administration, build stocks of human capital through learning-by-doing (Burkett et al., 1999; Putterman, 2000; Chanda and Putterman, 2004; Acemoglu et al., 2015).⁴ The accumulation of statehood experience increases a country's ability to consolidate power and creates a capable bureaucracy, yielding "state capacity" (Bockstette et al., 2002; Chanda and Putterman, 2007; Besley and Persson, 2009; Besley et al., 2013).⁵ Thus, longer statehood experience implies greater opportunities to experience the effects and drawbacks of existing laws and legal systems, greater bureaucratic capacity and more frequent chances for reform. However, an opposing view is that older states have a more entrenched

³ According to Berkowitz et al. (2003), what matters is whether the transplanted law was developed domestically, if it was received through colonization but adapted to local conditions, or if the local population already had some familiarity with its legal principles. Then the demand for the law would be high and it would be used effectively to enhance economic development.

⁴ The long-term determinants of comparative development have been discussed by, for example, Kremer (1993), Galor and Weil (2000), Comin et al. (2010), Putterman and Weil (2010) and Chanda et al. (2014).

⁵ A longer history of statehood (sometimes denoted "state antiquity" in the literature) often implies a stronger state capacity in the form of legal and fiscal capabilities (Besley and Persson, 2009; Becerra et al., 2012). Statehood experience has gained considerable attention in the literature on long-run comparative economic development in recent years, explaining poor growth rates and low income levels (Bockstette et al., 2002; Chanda and Putterman, 2007; Putterman, 2008; Putterman and Weil, 2010), bad institutions (Bockstette et al., 2002; Ang, 2013b), unequal distribution of income (Putterman and Weil, 2010), and financial underdevelopment (Ang, 2013a). A longer state history is generally found to be associated with more favourable economic outcomes.

political class and special interest groups bent on self-enrichment by blocking financial development because financial deepening increases competition (Rajan and Zingales, 2003).

To sum up, one of our competing hypotheses is that adaptable civil law legal systems have negative effects on financial development, but that longer statehood experience mitigates or reverses these negative effects. Thus, statehood experience should reduce the negative effects on financial development of German and Scandinavian civil law.⁶ The alternative hypothesis is that adaptable civil law legal systems have negative effects on financial development, and longer statehood experience worsens these negative effects. Finally, statehood experience is not expected to improve or worsen financial development in countries with French civil law, because this legal system is highly rigid.

Using a cross section of up to 127 countries, our results lend support to the first hypothesis. Our estimates suggest that in countries with modest statehood experience, German and Scandinavian civil law systems all have a direct negative effect on financial development, measured as average domestic credit as a share of GDP over the years 2000-2009. In a sense, countries with these legal systems experienced legal origin-induced financial underdevelopment as their financial development suffered where statehood experience was short. However, longer statehood experience, measured as state history over the period 1-1950AD, mitigates or reverses this negative effect for countries with German and Scandinavian civil law legal origins. We believe this is a novel finding in the literature.

Interestingly, our results also indicate that French civil law has no or at most a weak negative effect on financial development. This is in contrast to the existing literature which does not take the interaction between legal tradition and statehood experience into account (for a survey, see La Porta et al., 2008). Moreover, state history does not affect financial development in countries with a French civil law origin. It turns out that these countries experience at most a minor legal origin-induced financial underdevelopment, with no reversal or improvement in financial development occurring over time. We subject our main results to extensive robustness analysis, and these findings remain largely intact.

Finally, we also extend our framework to analyze three additional issues. We find that our general approach is useful in explaining changes in stock market development, financial

⁶ This argument is reminiscent of Watson's (1974) suggestion that differences across legal systems may diminish over time through a process of transplantation.

integration, and financial crisis. Drawing from the insights of Rajan and Zingales (2003), this paper uses historical stock market data to show that legal origins, changes in the accumulation of statehood experience, and their interaction can help explain historical and recent changes in stock market development over the periods 1913-1960 and 1991-2007, respectively. Given that the decision to reform and open up a financial system depends on the state, this paper also seeks to explain the variation of financial integration across countries (see Bekaert et al. (2007)). Similarly, since the safeguards built into financial systems are partially determined by the state, our framework is utilized to shed light on the historical incidence of financial crisis (see Reinhart and Rogoff, 2009, 2011).

The present paper is related to Ang (2013a), who shows that current differences in financial development between countries can be significantly explained by the variations in their statehood experience from 1-1950 AD. Additional results indicate that the total effect of state history on financial development is mediated by some institutional factors, namely government effectiveness and control of corruption. The current paper departs from Ang (2013a) in several important ways, however. First, Ang (2013a) tests the hypothesis that a longer history of statehood is favorable for improving the financial system. In contrast, our paper hypothesizes that while a civil law legal origin has a negative effect on financial development, a longer duration of statehood either strengthens or weakens this effect. However, this occurs only when the civil law legal system has some flexibility. Thus, while the literature has treated adaptability and the history of the state as separate explanations for financial development, we argue that they should not be studied in isolation. Moreover, the current paper examines the importance of quality-adjusted statehood experience. Finally, it also discusses the role of flexible legal systems and state history on changes in stock market development, financial integration, and the propensity for financial crisis. .

The paper proceeds as follows. Section 2 provides a discussion of the empirical specification, estimation issues and data. The empirical estimates are presented and analysed in Section 3. Several robustness checks are performed in this section, which includes the use of alternative measures of financial development, statehood experience and legal tradition, the consideration of some potentially confounding variables (including income per capita), and addressing endogeneity concerns. We also study changes in the development of stock markets over time. Section 4 conducts some additional analysis of these results. This includes accounting

for the quality of the state, and considering different sub-periods and components of state history. Section 5 analyses financial integration and financial crisis. The last section summarizes our findings and provides concluding comments. Appendix I provides variable definitions and sources, and a table of countries used in the estimations.

2. Empirical Approach

2.1 Regression Model

The following model is regressed to investigate how financial development is related to statehood experience and legal origin in country i :

$$FinDev_i = \alpha + \beta State_i + \gamma_1 LegOr_{li} + \gamma_2 State \times LegOr_{li} + \theta cv'_i + \varepsilon_i \quad (1)$$

where $FinDev$ is a measure of financial development, $State$ is a measure of statehood experience covering the period 1–1950AD, $LegOr_{li}$ is a dummy variable for countries classified as having legal tradition l , cv'_i is a set of control variables included in regressions to allow for the influence of some contemporary and geographic effects, and ε_i is an unobserved error term.

We include a full set of legal origins based on the approach of Klerman et al. (2011), i.e., *French Civil Law LO*, *German Civil Law LO*, *Scandinavian Law LO*, *Islamic Law LO*, and *Mixed Law LO*. *Common Law LO* is the excluded category. *Mixed Law LO* is a dummy variable for countries classified as having a combination of common and civil law traditions (i.e., mixed).

Our main variables of interest are the interaction terms $State \times LegOr_l$, where $l = \textit{German Law LO}$, *Scandinavian Law LO* and *French Civil Law LO*. Under the hypothesis that state history has a positive effect on the functioning of adaptable legal systems, the interaction term is expected to take a positive and significant sign for the first two types of legal origin, but not for *French Civil Law LO*. In this case, a longer state history leads to increased financial development, but only where the legal system is adaptable. Alternatively, if state history is associated with a decline in financial development where legal systems are flexible, the terms $State \times \textit{German Law LO}$ and $State \times \textit{Scandinavian Law LO}$ should exhibit negative signs. $State$ will have a direct positive (negative) effect on $FinDev_i$ if statehood experience

provides conditions favorable (unfavorable) for the development of financial systems and this effect does not depend on legal traditions.

2.2 Data

Financial Development (FinDev). Following standard practice in the literature, we use average domestic credit to private sector (or total financial resources provided to the private sector) as a share of GDP year 2000-2009 as our main indicator of financial development. As opposed to monetization ratios, such as M2/GDP, which considers the total claims on the entire non-financial sector, the use of domestic credit to private sector as a share of GDP has a major advantage in that it focuses only on intermediary claims on the private sector. This indicator therefore captures one of the most important activities of financial intermediaries - funneling savings to investors (Beck et al., 2000). As a robustness check, we also use several other indicators of financial development commonly used in the literature. All financial data are taken from the Global Financial Development Database (GFDD) of the World Bank.

State history (State). We employ version 3.1 (the latest version) of the state history data assembled by Putterman (2004). This data set provides state antiquity data covering 39 half centuries from 1 AD to 1950 AD for 151 countries. This index of state history reflects: (1) the presence of a government above the tribal level; (2) whether this government is foreign or locally based; and (3) the proportion of the current territory covered by this government.

To illustrate, state history (*State*) for the nineteen and a half centuries to 1950 AD is calculated as follows:

$$State_i = \frac{\sum_{t=1}^{39} (1.05)^{1-t} \cdot S_{i,t}}{\sum_{t=1}^{39} (1.05)^{1-t} \cdot 50} \quad (2)$$

where $S_{i,t}$ is the state presence for country i for the fifty-year period t (see Putterman and Weil, 2010). A 5 percent discount rate is applied to each of the half centuries so that declining importance is attached to state experience from the more distant past. The estimates are insensitive to the use of alternative depreciation rates ranging from 0 to 15 percent. The approach used to measure state antiquity is broadly consistent with Bockstette et al. (2002), Chanda and Putterman (2007), Putterman (2008), Putterman and Weil (2010), and Ang (2013a, b). The index

is converted to a scale from 0 to 1 where higher values reflect the presence of a longer state history. For more details, see Appendix II.

Although our benchmark models utilize state history data until 1950 AD, in the robustness analysis state experiences accumulated up to 500 AD, 1000 AD, 1500 AD and 1750 AD are also considered in order to check if the results are driven by the period chosen. This consideration is important since, for example, according to Malmendier (2009), Ancient Roman Law was quite flexible (and the same could hold true in other countries before the new legal systems were transplanted), we also examine how statehood over the period 1750-1950 AD and its interaction with legal origins shape financial development. This period reflects the time after the European Age of Discovery and Exploration .

Legal origins (LO). The legal tradition of company law or the commercial code for each country is classified into *French LO*, *German LO*, *Scandinavian LO*, *Islamic LO*, and *Mixed LO*, with *British common law LO* being the excluded category, using binary variables. We follow the legal tradition classification of Klerman et al. (2011). This has the advantage of enabling us to identify colonies which were influenced by both civil and common legal structures (*Mixed*), which may influence the results. For example, South Africa and Sri Lanka are both coded as having a *Mixed LO* since they were initially colonized by the Dutch and therefore had inherited a civil law tradition. However, this legal system was partially replaced with common law as they were subsequently conquered by England (Klerman et al., 2011). Note that the mixed legal heritage emerged due to exogenously determined events from the colonies' perspectives, and no voluntary choice of legal system was made.

Klerman et al. (2011) also classify six countries as Islamic. However, since only Yemen is part of our sample of 127 countries, *Islamic LO* was not included in the estimations. These classifications are in contrast to the more traditional classification approach of La Porta et al. (1998). Klerman et al. (2011) are legal scholars, who may be expected to have a detailed understanding of countries' legal histories. However, in the robustness analysis we also consider the legal system classification of La Porta et al. (2008).⁷

⁷ There is no consensus in the literature with regard to the classification of legal traditions. For example, Japan is coded as having German civil law tradition in the current study. Yet some historians argue that the Japanese civil code combines elements of both French and German legal traditions. Given this ambiguity, it is necessary to check if our results are sensitive to which legal tradition is assigned to Japan. However, our findings are almost intact when Japan is recoded as having a French legal tradition.

After assembling the various sources of data, 127 observations remain. Table 1 provides the summary statistics of the key variables, as well as the respective correlations coefficients with *FinDev*. For example, *French LO* is negatively correlated with *FinDev*, as expected. *State* and *FinDev* are positively and highly correlated. In particular, our data show that older states (*State* > 0.75) such as Denmark, the United Kingdom, France, Japan, South Korea, Portugal and Switzerland all have deep financial systems whereas those with states formed only after 1500 AD, such as Papua New Guinea, the Central African Republic, Gabon, Togo and Sierra Leone, tend to have less developed financial systems.

[Table 1]

Figure 1 provides the distribution of accumulated state experience from 1 AD to 1950 AD for all 151 available countries in Putterman (2004) where state antiquity is derived using Eq. (2). It is apparent that state antiquity shows a wide disparity across countries. Figure 2 shows how the values of statehood experience are distributed across different types of legal traditions. As is evident, countries that inherited the German and Scandinavian legal origins tend to have more experienced states. In contrast, countries that inherit the British and “mixed” legal systems tend to have relatively less experienced states. This evidence suggests that there may be a strong interplay between statehood experience and legal tradition. See Table A1 in Appendix I for the definition of all variables and their sources. Table A2 provides a list of all included 127 countries, their legal origins, and their 1-1950AD state histories.

[Figure 1]

[Figure 2]

3. Results

3.1 Key findings

The estimation results of Eq. (1) are presented in Table 2. We consider several alternative specifications to ensure that the results are not driven by any particular model specification. In particular, we include *State*, several geographic control variables (including island dummy, landlock dummy, absolute latitude, distance to coast, mean elevation, precipitation and terrain ruggedness) and continent dummies in all regressions. This reduces the possibility of obtaining spurious estimates. Each type of legal tradition, including French civil law, mixed, German and Scandinavian legal origin (British common law is the excluded group), and its interaction with statehood experience is sequentially added to the specifications in columns (1) to (4).

[Table 2]

Several observations are in order. First, the coefficients of *State* are positive and highly significant in some cases, providing some evidence to suggest that the existing differences in financial development between countries can in part be explained by the cumulative variations in their levels of state experience from 1-1950 AD. Second, columns (1) and (2) show that countries with French civil law and mixed law traditions do not seem to have systematically higher or lower levels of financial sector development, and these relationships also do not hinge on the extent of statehood experience. Third, the results in column (3) show that while countries with *German Law LO* (relative to that of British common law legal origin) tend to be associated with lower levels of financial development, this relationship is moderated by the length of statehood experience. Both the direct and indirect effects of *German Law LO* are found to be highly significant at the 1% level. Fourth, the findings in column (4), in terms of how *Scandinavian Law LO* and its interaction with statehood experience are related to financial development, are similar to those reported in column (3).

In light of these findings, we provide a “horserace” for these two types of legal origins in column (5). The earlier results hold, where the coefficients of *German Law LO*, *Scandinavian Law LO* and their interactions with *State* are very precisely estimated at the 1% significance level. They also carry signs consistent with the findings in columns (3) and (4). The results are also largely consistent when all types of legal origin classifications are included in the same specification in the last column. *State* is not significant in either model (columns (5) and (6)).⁸ Thus, our analysis suggests that *State* does not have a direct effect in most countries, only those with German and Scandinavian legal origins. This is a more nuanced view of the effect of *State* than in the previous literature (see Ang, 2013a). However, we note that the simultaneous use of *State* in multiple interactions is quite taxing on this variable, and thus some caution should be exercised when interpreting this particular result. Moreover, the results do not support the law and finance theory of La Porta et al. (1997, 1998), which predicts that countries with a French

⁸ Bearing in mind that our *State* measure ends in year 1950 (making extrapolating to recent times more difficult), we can use the estimate in column (6) of Table 2 as an illustration of our argument. The marginal effect of *German LO* on *FinDev* equals $-0.563 (= -1.241 + 1.496 \times 0.453)$. The total effect of *German LO* on *FinDev* thus turns positive when *State* reaches 0.833. In our sample, three East Asian economies have sufficiently old states for *German LO* to have a positive effect: Japan, Korea and China satisfy this threshold. Others such as Austria, Switzerland, and Bulgaria, do not. For *Scandinavian LO*, the threshold is lower at a *State* value equal to 0.653. Of the five *Scandinavian LO* countries in our sample, only Denmark meets this requirement (the other four are Finland, Iceland, Norway and Sweden).

civil law legal origin favor institutions that tend to block financial system development. We find no effect of French civil law relative to British common law.

On the whole, the significant effects of the interactions between *State*, *German Law LO* and *Scandinavian Law LO* suggest that longer statehood experience improves the performance of these legal systems as the state and government gain experience and develop stronger legal and state capacities. Adaptable legal systems improve with time. However, the interactions of *State* with *French Civil Law LO* and *Mixed Law LO* are never significant. In other words, the relatively more rigid French civil law, unlike fine French wine, does not improve with age.⁹

3.2 Robustness of results

Next, we carry out several robustness checks of the results. The last column of Table 2, which is the complete specification of our regression model in Eq. (1), will be used as our baseline model for the purpose of this sensitivity analysis. That is, the estimations include all control variables used in the benchmark model but their estimates are not reported in order to conserve space.

3.2.1 Are the results confounded by income?

Our measure of statehood and income per capita are potentially correlated. Bockstette et al. (2002), for instance, demonstrate that statehood is a strong predictor of economic growth during the period 1960-95. They also show that it is correlated with the level of per capita income in 1995, although this correlation is not robust to the inclusion of some control variables. To the extent that state history captures the level of economic development, our results would be consistent with the alternative view that more developed countries in German and Scandinavian legal systems have better financial development. Several checks are in place to rule out this possibility. The results are reported in Table 3.

First, we directly control for real income per capita in 2000 (logged) in column (1). While

⁹ Historically, some countries such as Ethiopia, Japan, Thailand and Turkey voluntarily adopted a foreign legal system (mostly French and German) that was deemed conducive to their economic development. Other colonies were imposed a system of law by their colonizers. The nature of legal system transplantation may have some bearing on our results. Accordingly, we exclude countries which derive their legal structures from those that colonized them using the classification provided by Klerman et al. (2011). We find that our results remain very consistent in that the coefficients of *German Law LO*, *Scandinavian Law LO* and their interactions with *State* are still significant at least at the 5% level. All signs are in line with the previous findings. Note that the results also hold when we restrict the sample to only those countries that derive their legal structure from their colonizers.

the results show that income per capita is positively correlated with financial development, its inclusion in the specification does not change our main findings. Second, we include the interaction between income per capita and legal origin dummies in column (2) to check the possibility that the influence of German and Scandinavian legal origins depends more on the level of economic development rather than statehood experience. In this case, the coefficient of the interaction between income and *German Law LO* is insignificant whereas the estimate for *Income x Scandinavian Law LO* is weakly significant but negative. Importantly, the coefficients of *State x German LO* and *State x Scandinavian LO* remain positive and significant. In column (3), we add income per capita, although doing so may induce multicollinearity. In this case, the results are largely similar. Finally, we perform a falsification exercise by replacing statehood experience with income per capita in column (4). As is evident, the results do not support the view that more developed countries in German and Scandinavian legal systems have better financial development. In sum, our results do not appear to be confounded by income. This is not surprising since the correlation between our measure of state history and real income per capita (logged) is rather weak ($r = 0.274$).

3.2.2 Are the results sensitive to the omission of *other* potentially confounding variables?

The estimates we have obtained thus far may be confounded by some factors which are correlated with financial development, state history and legal origins. We deal with this concern by controlling for several effects which have been identified in the literature as potential confounding factors for the relationships examined.

First, as emphasized by Stiglitz and Weiss (1981), Aghion and Bolton (1992) and Djankov et al. (2007), creditor protection and information sharing are essential for reducing financial market frictions which may matter for the improvement of financial systems. Accordingly, column (1) in Table 4 includes measures of creditor rights protection, contract enforcement and information sharing as control variables.

[Table 4]

Second, Stulz and Williamson (2003) argue that Protestant culture emphasizes private property protection that promotes capitalism and financial development, whereas Catholics value the creation of a hierarchical centralized structure that empowers politicians, thus creating a system vulnerable to resource misallocation and financial backwardness. Since these effects may

be correlated with both statehood and financial development, we replace the additional control variables in column (1) with religious composition variables in 1900 to capture their influence.

Third, according to the endowment thesis of Acemoglu et al. (2001), the disease environment and colonial strategies are critical in shaping subsequent developmental outcomes. We therefore include colonial dummies in column (3) and an index of historical pathogen prevalence in column (4) to allow for the possibility that they may be correlated with our key variables, namely financial development, statehood and legal origins.

Next, statehood and financial development may also affect other developmental outcomes such as institutional quality, democracy, and international trade, rather than financial development. Consequently, we include these as control variables individually in columns (5) to (7). Better institutions, more democratic governance, increased trade openness and higher per capital income are all associated with higher levels of financial development.

Finally, a culture that focuses on rewarding innovation and creativity will be more prone to having citizens in favor of adaptable legal systems and more sophisticated financial systems. Consistent with the proposition of Triandis (1995) that individualism is a crucial factor that influences technology adoption, the recent empirical results of Gorodnichenko and Roland (2011) and Ang (2015a) show that countries imbued with an individualistic culture tend to have better innovation performance. Research has also established that individualism is positively associated with over-confidence, over-optimism, and self-attribution bias (Mihet, 2013; Breuer et al., 2014), and these behavioural biases affect an individual's preferences and habits in financial trading and ownership of wealth, which determine the sophistication of the financial system.

We control for this effect in column (8) by using a proxy for individualism developed by Kashima and Kashima (1998). They argue that whether pronouns (i.e., "I" and "You") are used in a language is associated with the extent of conceptual differentiation between the speaker and the social context. Languages that forbid the personal pronoun to be dropped tend to appear more frequently in societies whose cultures respect individual rights more, and hence the cultural emphasis is on the well-being of the individuals rather than the society at large. This implies that the grammatical rule that allows pronoun dropping is negatively related to individualistic culture scores. The pronoun-drop characteristic of a country's dominant language is a dummy variable indicating whether the language allows the personal pronoun to be dropped, where one indicates "allow" and zero otherwise.

Importantly, the estimates are not driven by any of these considerations in a significant manner. Our main results in terms of how German and Scandinavian legal origins and their interactions with statehood influence financial development **are consistent with those reported in the baseline model (Table 2, last column)**. French legal origin has a significant and negative effect in three columns in Table 4. This effect does not depend on statehood experience in either of the estimations.

3.2.3 Are the results robust to endogeneity?

The above empirical design implicitly assumes that state history is exogenous, and hence may give reasons to be concerned about whether the estimates represent causal relationships. In particular, we cannot rule out the possibility that the causality between modern-day financial development and state history since 1 AD may run in opposite directions. The initial endowments of finance in the economy may affect subsequent state development.

The alternative scenario of an omitted unobservable third variable cannot be ruled out either. For example, there may exist substantial variation in the hierarchy of historical institutional structures which drives the formation of territorial states. To the extent that less egalitarian institutions were influential in the early development of monetary systems, such unobserved heterogeneity may generate a spurious relationship between subsequent financial and state development. This prevents a causal interpretation of the results.

While we recognize that such potential endogeneity is a legitimate concern, establishing a credible identification strategy that satisfies the exclusion restriction assumption is incredibly difficult. Consequently, the estimates are likely to reflect correlations rather than causations.

To address potential concerns of endogeneity, we use the following variables as instruments for the statehood experience: the timing of agricultural transition, the average level of technology adoption in 1000 BC and 1 AD, and geographic proximity to the regional economic core in 1000 BC. The year 1000 BC is chosen since it is less likely to be driven by the presence of state in 1 AD. Furthermore, we use the average values of technology adoption in 1000 BC and 1 AD instead of only the former, since the data for technology adoption in 1000 BC are more sparsely available. The choice of these variables as instruments for identifying the model is motivated by the recent findings of Ang (2015b), who shows that an early transition to fully-fledged agricultural production, the adoption of state-of-the-art technological innovations,

and the opportunity for economic interaction with the regional economic leader are key drivers for the emergence and persistent development of states.

The creation and the persistent development of states is related to the timing of agricultural transition since, according to Diamond (1997), such a shift to fully-fledged agricultural production gave rise to rapid population growth where more extensive, complex and settled forms of agricultural societies gradually emerged out of the initial hunter-gatherer base. The improvement in agricultural productivity following the transition led to the onset of the institutionalization of power relations, the enhancement of fiscal capacity due to the ability to raise more tax revenues, and greater demand for protection from bandits by farmers that in turn subjected them to hierarchical leaders. Hence, settled agricultural villages with small-scale political entities governed by supra-tribal authorities subsequently compounded into larger polities and thereby fully-fledged states emerged. An earlier transition to agriculture therefore confers an early developmental head start in building state capacity.

Lastly, geographical barriers or isolation can hinder state development by imposing higher costs of trade and reducing economic interaction across borders (McNeill, 1982). In contrast, proximity to the economic leader in the region provides a channel for knowledge and state experience diffusion, which in turn enhances state capacity. States that lacked the opportunities for trade and did not possess the means to facilitate trade, production, and the modernization of their economies were likely to fail, be displaced by others and hence experience retarded state development (Spruyt, 2002).

Changes in the technological environment may also matter for state formation. Tilly (1992) emphasizes that sporadic technological discovery in the methods of warfare and weapon systems was one of the key drivers giving rise to the formation of states in ancient societies, particularly in the era of Babylonia, Assyria, Ancient Persia, etc. Such military innovation was also a major engine of state development throughout Europe in the medieval and early modern periods. Roberts (1956) argues that technological innovations in early modern Europe significantly increased the need to support a larger army, which induced the creation of centralized states through higher demand in the areas of logistical, financial and administrative support. States that were unable to provide such support were weeded out (Tilly, 1992).

The results are reported in Table 5. We utilize technology adoption as the main instrument and agricultural transition timing and geographic proximity to the regional core as

additional instruments for *State* and its interactions with different legal origin dummies. That is, column (1) uses only technology adoption as the instrument, different pairs of instruments are used in columns (2) and (3), and the last column uses all three instruments in the estimations. The instrumental variable results are broadly in line with those found using the OLS estimator, suggesting that we can plausibly interpret the results in a causal sense.

[Table 5]

Our identification strategy is only valid under the assumption that these early development indicators affect financial development via their influence on the endogenous regressors. The score's over-identification test indicates that the exclusion restriction assumption is likely to be satisfied. The tests, however, are known to have low power.

Given that multiple endogenous regressors are used, we adopt the procedure of Shea (1997) for testing instrument relevance. This approach tests for the strength of the relationship between every endogenous variable and the excluded instruments, after partialling out the included instruments and other endogenous variables.

A small value of the Shea partial *R*-squared indicates that the instruments lack sufficient relevance to explain all the endogenous regressors. The Shea's partial R^2 statistics range from 0.19 to 0.77, providing evidence that the instruments are quite strongly correlated with the endogenous variables. Hence, on the basis of these findings, we conclude that our instruments are sufficiently relevant.

Additionally, we also report the Anderson-Rubin (1949) and Stock-Wright (2000) test-statistics, which are robust to weak instruments. In all cases, these tests reject the null hypotheses that the coefficients of the excluded instruments are jointly equal to zero at conventional levels of significance, thus providing evidence that the endogenous regressors have some explanatory power even in the presence of weak instruments.

3.2.4 Are the results sensitive to the use of alternative measures of financial development?

Note that thus far we have measured financial development using total financial resources provided to the private sector as a share of GDP. In Table 6, column (1) uses the ratio of deposit money bank asset to GDP as the measure of financial development. The assets include claims on the government, public enterprises, and the private sector. Column (2) considers financial resources provided to the private sector only by deposit-taking financial institutions as a share of

GDP as the outcome variable. Column (3) uses household credit to GDP as the proxy for financial development. Column (4) considers the credit dependency data of Becerra et al. (2012), which measures the extent to which incumbents support financial development. Finally, column (5) reconstructs our baseline measure of financial development (i.e., domestic credit to private sector/GDP) using data from 2000 to 2005, prior to the onset of the global financial crisis.

[Table 6]

As reported in the table, while the estimates vary slightly in some cases they are broadly in line with those of the baseline model used in the last column of Table 2. In particular, column (1) shows that the results are similar when the ratio of deposit money bank asset to GDP is used as the measure of financial development. While the significance of *State x Scandinavian LO* disappears when we use private credit by deposit money bank to GDP (columns (2)), household credit to GDP (columns (3)), and credit dependency ratio (columns (4)) as the dependent variable, the coefficients of *State x German LO* remain precisely estimated.¹⁰ The results in column (5) also remain similar when we restrict the period to 2000-2005 when constructing the measure of domestic credit to private sector/GDP.

3.2.5 What about changes in statehood experience and stock market development over time?

In this sub-section, we examine how changes in financial development are related to changes in statehood experience and legal origin. This consideration is especially important given that Rajan and Zingales (2003) document a great reversal in financial development starting in 1913. Table 7 shows the average changes in the stock market capitalization ratio between: (1) 1913 and 1960; and (2) 1991 and 2007, which are classified according to legal origins. The table uses historical and recent stock market data from Rajan and Zingales (2003) and Beck and Demirgüç-Kunt (2009), respectively. There were some significant changes in the development of stock markets over both time periods. Except for the British legal origin countries which experienced deepening in the stock markets over the period 1913-1960, all other groups experienced a reversal in stock market development. The reduction in the ratio is especially large

¹⁰ Three stock market development indicators are also used, which include the ratio of stock market capitalization to GDP, stock market turnover ratio, and the ratio of stock market total value traded to GDP. However, only the results for the stock market turnover ratio (not reported) are consistent with our earlier findings. This result suggests that our conceptual framework is more consistent with a bank-based financial system.

for the French legal origin group but smaller for the German and Scandinavian groups (note that there are no data available for the mixed legal origin group).

[Table 7]

When more recent data are used, we can see that the British legal origin countries experienced the fastest development in stock markets from 1999 to 2007 among all legal origin groups, providing evidence consistent with the historical data. Increases in the stock market capitalization ratio for the German and Scandinavian legal origin groups are also remarkable. Given that Figure 2 indicates that countries with German and Scandinavian legal origins have significantly more experienced states relative to countries with a British common law origin, the evidence here implies that the reduction in the size of the stock market is potentially mitigated by greater statehood experience for both the German and Scandinavian groups.

Did the change in accumulated statehood experience, and legal origins, influence this reversal? To answer this question, we provide a regression analysis using a similar framework. The first five columns of Table 8 consider the change in stock market development from 1913 to 1960, using the historical stock market data of Rajan and Zingales (2003). Note that the sample size is rather small in this case since very few countries had a stock market back in 1913. The last five columns consider more recent changes in stock market development, using data from Beck and Demirgüç-Kunt (2009) for 1991 to 2007, which yields a larger number of observations.¹¹ In each model, the change in statehood experience ($\Delta State$) is chosen to begin from different periods (51AD, 501AD, 1001AD and 1851AD). The period always ends before the change in the stock market development measure (ΔMCY) begins (1900 AD for historical data and 1950 for contemporary data). For example, $\Delta State$ from 501 AD to 1900 AD is defined as statehood experience accumulation from 1-1900 AD minus the accumulation over the period 1-500 AD.

[Table 8]

The results indicate that in four out of ten cases, our main results for *German LO* prevail since either the coefficients for *German LO* are negative or the coefficients for $\Delta State \times German LO$ are positive. For example, column (2) suggests that while the 1913-1960 period stock market development was hampered by having a *German LO*, a greater increase in

¹¹ Year 2007 is chosen as end point to avoid the influence of the severe financial and economic crises occurring thereafter.

statehood experience during the prior 501-1900 AD period mitigated this disadvantage. Column (10) indicates a similar effect of the change in statehood experience between 1901 and 1950 for the financial development in *Scandinavian LO* economies from 1991 to 2007.

Note that in columns (2) and (7), both the coefficients of *German LO* and its interaction with $\Delta State$ are significant and this allows us to assess how the effect of *German LO* on the change in the stock market capitalization ratio depends on changes in statehood experience. Notice however that the estimates using historical stock market development data are somewhat restrictive since they are based on a small sample of 17 countries, which include only two *German LO* countries (Germany and Japan). We will therefore give more emphasis to the results based on the use of more recent stock market data. In particular, the results in column (7) indicate that a one standard deviation increase in $\Delta State$ over the period 501-1950AD above its mean (0.454) for *German LO* countries would result in 0.661 ($-2.319 + 6.564 * 0.454$) units increase in $\Delta MCY_{1991-2007}$ (this is equivalent to 1.122 standard deviations). The results therefore imply that our framework may also be adopted to explain changes in the level of financial development over time.

3.2.6 Are the results sensitive to the use of alternative measures of statehood experience and legal tradition?

Moreover, we use alternative statehood variables constructed with a zero decay rate, and a 15% decay rate (the baseline measure uses a 5% depreciation rate). Very long term data on state experience from 3500 BC to 1500 AD, obtained from Borcan et al. (2014), are also used. Finally, an alternative classification of legal traditions by La Porta et al. (2008) is used. **In a majority of the cases, the coefficients of both *German Law LO* and *Scandinavian Law LO* are significant and negative whereas the coefficients of their interaction with statehood experience are significant but positive** (see the details in section III.A of Appendix III).

4. Further Evidence

4.1 The quality and fragility of states

So far, our measure of statehood experience does not take into account the quality of the government accumulating this experience. If significant accumulation is experienced by governments with poor quality of governance (e.g., North Korea), statehood experience may be

detrimental to financial development. Relatedly, the results of Bekaert et al. (2011) suggest that political risk predicts important financial outcomes such as financial openness. It therefore appears relevant to explore how financial development responds to the quality and fragility of states.

First, since our measure of statehood experience does not capture any information regarding the degree of political centralization, we adjust our statehood experience measure by multiplying it with the Polity IV democracy index (column (1)). In this case, while the coefficient of *State x German LO* loses significance, the coefficient of *State x Scandinavian LO* is still significant at the 5% level with the correct sign. Next, we adjust our statehood experience measure by multiplying it with the following six different indicators of political instability risk individually: (1) Barro-Lee's (1994) political instability index; (2) Alesina et al.'s (1996) political instability (major changes) index; (3) Bank-Wilson's (2017) regime instability index; (4) Bank-Wilson's (2017) within-regime instability index TWO; (5) Bank-Wilson's (2017) violence index; and (6) Esteban et al.'s (2012) incidence of civil war index. All these indices are reverse coded so that higher values reflect greater political stability. The findings are given in Table 9. **In many cases, the results are consistent with the baseline specification since the coefficients of both *German Law LO* and *Scandinavian Law LO* are significant and negative whereas the coefficients of their interaction with statehood experience are significant but positive.** There is little evidence suggesting that political instability or violence matters for our results.

[Table 9]

4.2 Sub-periods of state development

This sub-section performs some additional empirical investigations by considering statehood experience accumulated over different sub-periods. When the sub-periods 1-500 AD, 1-1000 AD, 1-1500 AD, and 1-1750 AD are considered, the results demonstrate that the length of statehood matters whereby an older state is equipped with greater capacity to improve adaptable legal systems. Next, we turn to considering statehood experience accumulated more recently by using the following sub-periods: 501-1950 AD, 1001-1950 AD, 1501-1950 AD, and 1751-1950 AD. The evidence here again suggests that countries with more state experience have greater capacity to improve their adaptable legal systems. The results are reported in Table A4 in

Appendix III.B.

4.3 Heterogeneous effects of state experience

The statehood experience measure used in this paper is obtained by multiplying three sub-indices: state presence (whether a government above the tribal level was present), state autonomy (whether this government was foreign or locally based) and state coverage (the extent to which the territory of the modern country was ruled by this government). The availability of this disaggregated information allows us to explore how financial development responds to different components of statehood experience. The results show that a locally-based government has a greater susceptibility and incentive to improve its legal system with increased accumulated state experience, provided the system is adaptable. The results are reported in Table A5 in Appendix III.C.

5. The Effects on Financial Integration and Financial Crisis

5.1 The effects on financial integration

This sub-section tests the effects of statehood experience, legal origins and their interactions on financial integration. Our framework can potentially explain the extent of financial integration given that the decision to reform and open up a financial system is a state decision.

Analyzing the effect on financial integration is particularly relevant since Bekaert et al. (2007) show that countries with more liberalized capital accounts, equity markets, and banking systems tend to have higher standards of living. They are more able to realize their growth opportunities (measured using the price-to-earnings ratios of global industry portfolios weighted by the country's industrial mix). They also find that capital market openness is a more effective conduit than financial development. Additionally, our findings may potentially have implications for economic growth. Bekaert et al. (2005) and Bekaert et al. (2011) show a positive correlation between financial openness and growth, whereas Bekaert et al. (2006) document that financial liberalization is associated with lower growth volatility.

We use financial integration data from the following sources: the capital account openness data of Quinn et al. (2011), and two financial reform indices (the international capital flow openness index and the overall financial reform index) of Abiad et al. (2010). While these

three variables capture different aspects of financial integration, an increase in the values of these variables generally implies greater integration. The detailed definition of these variables is given in Appendix I. The results are given in Table 10.

[Table 10]

First, we test the effects on the openness of capital flows using the capital account openness index of Quinn et al. (2011) and the international capital flow openness index of Abiad et al. (2010). The results in columns (1) and (2) show that the coefficients of *Scandinavian LO* are significant and negative whereas the coefficients of *State xScandinavian Law LO* are significant and positive, which is consistent with our prediction. Next, legal origins and the duration of statehood may affect policy makers' ability to undertake reform and open up the financial system in order to deepen it. We test this possibility using the overall financial sector reform index of Abiad et al. (2010) (column (3)), which gives similar findings.

5.2 The effects on financial crisis

Next we test the effects of statehood experience, legal origins and their interactions on the incidence of financial crisis. The safeguards built into financial systems are at least partially determined by the state, thus offering our framework the opportunity to shed new light on the historical incidence of financial crisis. Our analysis complements Beck et al. (2006), who report that during 1980-1997, British common law and German civil law legal origin countries (but not French civil law countries) had lower probabilities of a banking crisis than other countries. Beck et al. (2006) do not take statehood experience into account, however.

We use data from Reinhart and Rogoff (2009) on episodes of financial crisis for more than two centuries, starting in 1800. We examine the effects of statehood experience, legal origins and their interaction on financial (banking) crisis over the following four periods: early crises (1800-1900); later crises (1901-2008); recent crises (1950-2008); and the whole period (1800-2008). In each period, we calculate the total number of occurrences of financial crisis (years in crisis by country).

During the early crisis period (1800 to 1900), 147 crises were reported. Only 29 out of 134 countries experienced at least one crisis. Over the next century, the number of reported crises increased nearly five-fold to 705. During this period, only Ireland and Mauritius did not experience any crisis. Of the 705 crises, over 80% occurred in the second half of the 20th century.

As argued by Reinhart and Rogoff (2011), greater financial development appears positively associated with banking crisis. In our sample, the simple correlation between financial development and the total number of financial crises during 1800-2006 equals 0.503 ($p=0.000$). The only legal origin with a significant simple correlation with financial crisis is *Scandinavian Law LO* (corr.=0.187; $p=0.035$). The simple correlation between statehood experience (1-1950AD) and financial crisis equals 0.215 ($p=0.015$).

[Table 11]

The results in Table 11 suggest that *German Law LO* and *Scandinavian Law LO* are directly associated with a lower frequency of financial crisis, relative to British common law legal origin. This effect is moderated by the length of statehood experience, however. The longer accumulated statehood experience is at the beginning of the period studied, the higher is the frequency of crisis. All relevant coefficients have consistent signs. Moreover, all *German Law LO* coefficients and two of the *Scandinavian Law LO* coefficients are significant at conventional levels. The *German Law LO* coefficient sizes tend to be larger than those for *Scandinavian Law LO*. No corresponding effects are found for *French Law LO* countries.

In sum, it appears that the benefits associated with the accumulation of statehood experience by countries with adaptable legal systems are primarily concentrated on building institutions that encourage financial development. Statehood experience does not appear to build up institutional mechanisms that help prevent or end financial crisis.

6. Summary and Conclusions

A country's histories of, for example, agricultural development, urbanization, money, taxation, and government administration all build stocks of human capital and experience. One view is that the cumulative experience with statehood influences a country's ability to consolidate power and create a capable bureaucracy, which may be summed up as "state capacity." An opposing perspective is that a longer state history could lead to the further accumulation of power by entrenched politicians and interest groups whose objective is only private enrichment. Either way, longer statehood experience gives countries with adaptable legal systems (German and Scandinavian civil law) more time to adapt their laws, for better or for worse.

While caution must be exercised when interpreting the results since they are derived based on a sample of 127 observations, the findings are quite consistent. We find that, relative to

British common law countries, countries that inherit the German or Scandinavian civil law tradition tend to exhibit lower levels of financial development. French civil law yields the same as, or only weakly lower financial development than, British common law. However, financial development improves in German and Scandinavian civil law countries as their history of statehood grows longer. This is not the case in French civil law countries, which have a more rigid legal system. We also find that legal origins and statehood experience help explain stock market development, financial integration, as well as the propensity for financial crisis. .

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Table 1: Descriptive statistics and correlation coefficients of key variables

Variable	Mean	Std. Dev.	Min.	Max.	Correlation with <i>FinDev</i>
<i>FinDev</i>	0.491	0.456	0.025	1.885	1
<i>State</i>	0.453	0.243	0.021	0.964	0.31
<i>French LO</i>	0.492	0.501	0	1	-0.35
<i>Mixed LO</i>	0.099	0.300	0	1	0.16
<i>German LO</i>	0.110	0.314	0	1	0.17
<i>Scandinavian LO</i>	0.028	0.164	0	1	0.27
<i>State x Civil Law LO</i>	0.239	0.275	0	0.964	-0.18
<i>State x Mixed LO</i>	0.030	0.121	0	0.748	0.15
<i>State x German LO</i>	0.086	0.224	0	0.938	0.24
<i>State x Scandinavian LO</i>	0.019	0.105	0	0.771	0.30

Notes: The descriptive statistics provided in the table include the 127 countries used in the baseline regressions. Sources and definition of data are described in the text and Appendix I.

Table 2: Main regression results

Dep. Var. = <i>FinDev</i>	(1)	(2)	(3)	(4)	(5)	(6)
<i>State</i>	0.699*** (2.721)	0.657*** (3.741)	0.312 (1.572)	0.507*** (2.713)	0.266 (1.316)	0.480 (1.226)
<i>French LO</i>	-0.145 (-0.855)					-0.245 (-1.110)
<i>State x French LO</i>	-0.195 (-0.661)					-0.096 (-0.240)
<i>Mixed LO</i>		0.329 (1.138)				0.111 (0.344)
<i>State x Mixed LO</i>		0.052 (0.079)				0.134 (0.196)
<i>German LO</i>			-1.057*** (-3.788)		-1.073*** (-3.541)	-1.241*** (-3.556)
<i>State x German LO</i>			1.515*** (3.748)		1.548*** (3.717)	1.496*** (2.794)
<i>Scandinavian LO</i>				-0.757** (-2.597)	-0.953*** (-2.905)	-0.973** (-2.411)
<i>State x Scandinav. LO</i>				1.618*** (3.381)	1.798*** (3.786)	1.490** (2.353)
<i>Island</i>	0.218 (1.542)	0.208 (1.505)	0.234* (1.683)	0.294** (2.051)	0.245* (1.730)	0.125 (0.891)
<i>Landlocked</i>	-0.152* (-1.712)	-0.144 (-1.491)	-0.114 (-1.168)	-0.138 (-1.405)	-0.119 (-1.206)	-0.120 (-1.343)
<i>Absolute latitude</i>	0.983** (2.519)	1.273*** (3.118)	1.195*** (2.958)	1.122** (2.540)	1.194*** (2.694)	1.247*** (3.124)
<i>Distance to coast</i>	-0.065 (-0.558)	-0.026 (-0.245)	-0.141 (-1.325)	-0.108 (-0.996)	-0.138 (-1.283)	-0.018 (-0.160)
<i>Mean elevation</i>	0.000 (0.513)	0.000 (0.402)	0.000 (0.862)	0.000 (0.980)	0.000 (0.902)	-0.000 (-0.091)
<i>Precipitation</i>	0.001 (1.269)	0.002** (2.218)	0.001 (1.365)	0.002 (1.620)	0.001 (1.307)	0.001 (1.334)
<i>Terrain ruggedness</i>	0.007 (0.208)	-0.005 (-0.144)	-0.016 (-0.492)	0.005 (0.136)	-0.014 (-0.439)	-0.011 (-0.330)
<i>America dummy</i>	0.135 (1.196)	0.088 (0.910)	0.097 (0.893)	0.088 (0.791)	0.097 (0.889)	0.139 (1.411)
<i>Asia dummy</i>	-0.155 (-1.302)	-0.164 (-1.228)	-0.008 (-0.065)	-0.066 (-0.524)	0.004 (0.029)	-0.137 (-1.048)
<i>Europe dummy</i>	0.021 (0.110)	0.004 (0.020)	0.158 (0.749)	0.059 (0.286)	0.165 (0.783)	0.109 (0.574)
<i>Oceania dummy</i>	0.154 (0.740)	0.258 (1.248)	0.161 (0.857)	0.163 (0.819)	0.144 (0.734)	0.108 (0.420)
<i>Constant</i>	-0.099 (-0.446)	-0.374** (-2.113)	-0.140 (-0.740)	-0.253 (-1.338)	-0.127 (-0.660)	-0.010 (-0.042)
R-squared	0.476	0.460	0.469	0.437	0.481	0.559
No. of obs.	127	127	127	127	127	127

Notes: The dependent variable is average private credit as a share of GDP year 2000-2009. Figures in the parentheses indicate robust *t*-statistics. ***, ** and * denote significance at the 1, 5 and 10% levels, respectively.

Table 3: Accounting for the role of income

	(1)	(2)	(3)	(4)
Dep. Var. = <i>FinDev</i>	Add income per capita	Add interaction terms for income per capita	Add income per capita and its interaction with legal origins	Replace statehood with income per capita
<i>State</i>	0.311 (1.155)	0.461 (1.128)	0.118 (0.508)	0.551 ^{***} (3.758)
<i>French LO</i>	-0.252 (-1.461)	-0.272 (-0.740)	1.479 ^{***} (4.300)	1.477 ^{***} (3.863)
<i>State x French LO</i>	-0.027 (-0.092)	-0.065 (-0.151)	0.305 (1.120)	
<i>Mixed LO</i>	-0.006 (-0.021)	-2.037 ^{**} (-2.703)	0.049 (0.051)	0.071 (0.075)
<i>State x Mixed LO</i>	0.216 (0.414)	-0.116 (-0.180)	0.343 (0.775)	
<i>German LO</i>	-0.966 ^{**} (-3.063)	-1.563 [*] (-1.824)	1.032 (1.315)	1.160 (1.015)
<i>State x German LO</i>	1.071 ^{**} (2.231)	1.395 ^{**} (2.348)	1.492 ^{***} (3.106)	
<i>Scandinavian LO</i>	-0.907 ^{**} (-2.159)	5.488 (1.508)	10.331 ^{**} (2.336)	7.136 (0.994)
<i>State x Scandinav. LO</i>	1.390 ^{**} (2.108)	1.750 ^{**} (2.743)	1.836 ^{**} (2.682)	
<i>Income</i>	0.209 ^{***} (5.398)		0.335 ^{***} (8.810)	0.334 ^{***} (8.761)
<i>Income x French LO</i>		0.002 (0.045)	-0.232 ^{**} (-4.609)	-0.215 ^{**} (-4.323)
<i>Income x Mixed LO</i>		0.260 ^{**} (2.518)	-0.017 (-0.137)	-0.002 (-0.014)
<i>Income x German LO</i>		0.044 (0.450)	-0.259 ^{***} (-2.675)	-0.172 (-1.415)
<i>Income x Scandinav. LO</i>		-0.632 [*] (-1.792)	-1.137 ^{**} (-2.699)	-0.726 (-1.058)
<i>Constant</i>	-1.467 ^{***} (-4.851)	-0.033 (-0.129)	-2.382 ^{***} (-9.530)	-2.583 ^{***} (-8.614)
R-squared	0.671	0.580	0.739	0.702
No. of obs.	127	127	127	127
Baseline controls	YES	YES	YES	YES

Notes: Figures in the parentheses indicate standard errors. ***, ** and * denote significance at the 1, 5 and 10% levels, respectively. All control variables used in the last column of Table 2 (our benchmark model) are included in the regressions but they are not reported to conserve space.

Table 4: Controlling for potentially confounding factors

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Dep. Var. = <i>FinDev</i>	Include credit protect. and info. sharing	Include religious compos. variables	Include colonial dummies	Include historical pathogen prevalence index	Include institut. quality index	Include democ. index	Include trade openness	Include individual ism proxy
<i>State</i>	0.09 (0.23)	0.33 (0.86)	0.49 (1.21)	0.50 (1.32)	0.27 (1.13)	0.08 (0.23)	0.31 (0.87)	-0.18 (-0.33)
<i>French LO</i>	-0.54** (-2.15)	-0.22 (-1.09)	-0.29 (-1.06)	-0.23 (-1.07)	-0.15 (-1.02)	-0.36* (-1.72)	-0.30 (-1.36)	-1.02* (-1.93)
<i>State x French LO</i>	0.49 (1.13)	0.03 (0.08)	-0.06 (-0.13)	-0.10 (-0.26)	0.01 (0.02)	0.29 (0.74)	0.12 (0.33)	0.98 (1.18)
<i>Mixed LO</i>	0.05 (0.13)	0.02 (0.07)	0.13 (0.40)	0.10 (0.33)	-0.01 (-0.03)	-0.05 (-0.17)	0.00 (0.01)	0.08 (0.12)
<i>State x Mixed LO</i>	0.02 (0.03)	0.44 (0.66)	0.13 (0.20)	0.17 (0.26)	0.16 (0.32)	0.46 (0.75)	0.42 (0.65)	-0.01 (-0.01)
<i>German LO</i>	-1.41*** (-4.37)	-1.35*** (-4.51)	-1.27*** (-3.33)	-1.31*** (-3.55)	-0.91*** (-3.34)	-1.35*** (-3.89)	-1.41*** (-4.21)	-2.76*** (-3.03)
<i>State x German LO</i>	1.75*** (3.61)	1.67*** (3.38)	1.55*** (2.79)	1.59*** (2.82)	1.06** (2.55)	1.84*** (3.55)	1.89*** (3.90)	3.25*** (2.76)
<i>Scandinav. LO</i>	-1.37*** (-3.22)	-1.42*** (-2.78)	-0.98** (-2.31)	-0.92** (-2.33)	-1.00** (-2.16)	-1.40*** (-3.78)	-0.94** (-2.23)	-1.90*** (-3.70)
<i>State x Scandinav. LO</i>	1.99*** (3.06)	1.41* (1.96)	1.48** (2.27)	1.36** (2.16)	1.52** (2.19)	2.24*** (3.87)	1.61** (2.51)	2.39*** (2.90)
<i>Creditor rights</i>	0.20 (1.65)							
<i>Contract enforcem. days</i>	-0.46** (-2.33)							
<i>Information sharing</i>	0.43*** (5.50)							
<i>% Catholics in 1900</i>		0.27* (1.77)						
<i>% Protestants in 1900</i>		0.91*** (3.39)						
<i>% Muslims in 1900</i>		-0.17 (-1.24)						
<i>Spanish colonial origin</i>			-0.03 (-0.14)					
<i>British colonial origin</i>			0.08 (0.45)					
<i>French colonial origin</i>			0.14 (0.99)					
<i>Portugese colonial origin</i>			0.19 (1.11)					
<i>Other European colonial origin</i>			0.28 (1.53)					
<i>Historic pathog. prevalence</i>				-0.14 (-1.18)				
<i>Institutions quality</i>					1.25*** (8.18)			
<i>Democracy index</i>						0.03** (2.26)		
<i>Trade openness</i>							0.00* (1.94)	
<i>Ln (income</i>								

<i>per capita)</i>								-0.12
<i>Individualism</i>								(-0.56)
<i>Constant</i>	-0.16	0.13	-0.15	0.16	-0.35**	0.15	-0.05	0.41
	(-0.62)	(0.53)	(-0.40)	(0.52)	(-2.07)	(0.67)	(-0.18)	(1.07)
R-squared	0.673	0.628	0.571	0.566	0.744	0.577	0.583	0.665
No. of obs.	114	127	127	127	127	125	126	63
Baseline controls	YES	YES	YES	YES	YES	YES	YES	YES

Notes: The dependent variable is average private credit as a share of GDP year 2000-2009. Figures in the parentheses indicate standard errors. ***, ** and * denote significance at the 1, 5 and 10% levels, respectively. All control variables used in the last column of Table 2 (our benchmark model) are included in the regressions but they are not reported to conserve space.

Table 5: Addressing endogeneity issues

Dep. Var. = <i>FinDev</i>	(1)	(2)	(3)	(4)
	IV = average technology adoption in 1000BC & 1AD	IV = agricultural transition + average technology adoption in 1000BC & 1AD	IV = proximity to regional frontier in 1000BC + average technology adoption in 1000BC & 1AD	IV = agricultural transition + average technology adoption in 1000BC & 1AD + proximity to regional frontier in 1000BC
<i>State</i>	0.639 (0.664)	0.467 (0.667)	0.094 (0.107)	-0.114 (-0.188)
<i>French LO</i>	-0.536 (-1.236)	-0.461 (-1.346)	-0.579 (-1.456)	-0.550* (-1.706)
<i>State x French LO</i>	0.478 (0.583)	0.337 (0.544)	0.603 (0.783)	0.560 (0.933)
<i>Mixed LO</i>	-0.086 (-0.170)	-0.155 (-0.358)	-0.143 (-0.296)	-0.115 (-0.261)
<i>State x Mixed LO</i>	0.888 (0.899)	0.972 (1.230)	0.787 (0.809)	0.585 (0.679)
<i>German LO</i>	-0.959 (-1.617)	-0.921** (-2.087)	-1.167** (-2.109)	-1.185*** (-3.274)
<i>State x German LO</i>	1.163 (1.125)	1.109 (1.458)	1.562 (1.587)	1.611** (2.543)
<i>Scandinavian LO</i>	-0.831 (-1.455)	-1.067** (-2.302)	-1.378** (-2.514)	-1.480*** (-3.394)
<i>State x Scandнав. LO</i>	1.235 (1.199)	1.636** (2.026)	2.210** (2.270)	2.392*** (3.176)
<i>Constant</i>	-0.164 (-0.299)	-0.079 (-0.190)	0.120 (0.243)	0.233 (0.668)
R-squared	0.520	0.549	0.547	0.548
No. of obs.	119	118	119	118
Baseline controls	YES	YES	YES	YES
Over-identification tests	-	5.58 [<i>p</i> = 0.35]	6.58 [<i>p</i> = 0.25]	10.95 [<i>p</i> = 0.28]
Anderson-Rubin Wald test	25.56 [<i>p</i> = 0.00]	45.67 [<i>p</i> = 0.00]	100.36 [<i>p</i> = 0.00]	45.10 [<i>p</i> = 0.00]
Stock-Wright LM S statistic	11.15 [<i>p</i> = 0.04]	16.87 [<i>p</i> = 0.08]	16.28 [<i>p</i> = 0.09]	17.20 [<i>p</i> = 0.10]
Shea's partial R-squared				
- <i>State x French LO</i>	0.42	0.41	0.37	0.47
- <i>State x Mixed LO</i>	0.49	0.45	0.40	0.79
- <i>State x German LO</i>	0.41	0.23	0.19	0.33
- <i>State x Scand. LO</i>	0.72	0.64	0.77	0.77

Notes: The dependent variable is average private credit as a share of GDP year 2000-2009. Figures in the parentheses indicate standard errors. ***, ** and * denote significance at the 1, 5 and 10% levels, respectively. All control variables used in the last column of Table 2 (our benchmark model) are included in the regressions but they are not reported to conserve space.

Table 6: Using alternative indicators for financial development

	(1)	(2)	(3)	(4)	(5)
	Dep. Var. = deposit money bank asset / GDP	Dep. Var. = private credit by deposit money bank / GDP	Dep. Var. = household credit / GDP	Dep. Var. = credit dependency	Dep. Var. = domestic credit to private sector / GDP from 2000 to 2005
<i>State</i>	0.738** (2.113)	0.757** (2.236)	0.380 (1.263)	0.023 (0.281)	0.559 (1.389)
<i>French LO</i>	-0.107 (-0.713)	-0.025 (-0.170)	-0.453** (-2.350)	-0.059 (-1.281)	-0.181 (-0.823)
<i>State x French LO</i>	-0.233 (-0.679)	-0.371 (-1.100)	0.530 (1.419)	0.013 (0.160)	-0.187 (-0.460)
<i>Mixed LO</i>	0.182 (0.840)	0.120 (0.575)	0.143 (0.705)	0.040 (0.640)	0.098 (0.304)
<i>State x Mixed LO</i>	0.083 (0.127)	0.163 (0.269)	-0.081 (-0.264)	-0.194 (-1.509)	0.303 (0.395)
<i>German LO</i>	-1.193*** (-3.482)	-0.936*** (-3.100)	-0.583** (-2.160)	-0.146** (-2.093)	-1.346*** (-3.733)
<i>State x German LO</i>	1.555*** (2.716)	1.041** (2.121)	0.706* (1.892)	0.244** (2.126)	1.760*** (3.051)
<i>Scandinavian LO</i>	-0.922** (-2.386)	-0.511 (-1.150)	-0.243 (-0.832)	-0.105 (-1.075)	-0.854** (-2.130)
<i>State x Scandinav. LO</i>	1.358* (1.925)	0.762 (1.005)	0.404 (0.909)	0.153 (1.057)	1.231* (1.852)
<i>Constant</i>	-0.071 (-0.317)	-0.193 (-0.893)	-0.213 (-1.239)	0.218*** (3.785)	-0.093 (-0.366)
R-squared	0.624	0.593	0.646	0.499	0.547
No. of obs.	127	127	45	114	127
Baseline controls	YES	YES	YES	YES	YES

Notes: Figures in the parentheses indicate standard errors. ***, ** and * denote significance at the 1, 5 and 10% levels, respectively. All control variables used in the last column of Table 2 (our benchmark model) are included in the regressions but they are not reported to conserve space.

Table 7: Changes in stock market development by legal origin

	Legal origin	Mean	Std. Dev.	Min.	Max.
Change in Stock Market Capital Ratio (1913-1960)	<i>French LO</i>	-0.273	0.435	-0.930	0.250
	<i>German LO</i>	-0.110	0.028	-0.130	-0.090
	<i>Scandinavian LO</i>	-0.117	0.188	-0.230	0.100
	<i>British LO</i>	0.328	0.367	-0.030	0.850
Change in Stock Market Capital Ratio (1991-2007)	<i>French LO</i>	0.458	0.302	-0.173	0.866
	<i>Mixed LO</i>	0.763	0.548	0.076	1.529
	<i>German LO</i>	0.813	0.823	0.154	2.016
	<i>Scandinavian LO</i>	0.803	0.277	0.533	1.151
	<i>British LO</i>	0.821	0.862	0.097	3.634

Notes: Stock market capitalization data for Mixed LO countries are not available.

Table 8: Changes in statehood experience and historical stock market development

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	Historical stock market development from 1913 to 1960 [col. (1) to (5)]					Recent stock market development from 1991 to 2007 [col. (6) to (10)]				
Dep. Var. = Change in stock market capitalization to GDP (ΔMCY)	$\Delta State$ is from 51- 1900	$\Delta State$ is from 501- 1900	$\Delta State$ is from 1001- 1900	$\Delta State$ is from 1501- 1900	$\Delta State$ is from 1851- 1900	$\Delta State$ is from 51- 1950	$\Delta State$ is from 501- 1950	$\Delta State$ is from 1001- 1950	$\Delta State$ is from 1501- 1950	$\Delta State$ is from 1851- 1950
$\Delta State$	-0.22 (-0.12)	3.18 (1.46)	5.65 (1.66)	4.43 (0.73)	-0.04 (-0.05)	-1.25 (-1.02)	-0.54 (-0.46)	-0.24 (-0.15)	0.96 (0.40)	-12.03 (-0.80)
<i>French LO</i>	0.09 (0.07)	1.08 (1.82)	0.78 (1.27)	0.01 (0.01)	-6.87* (-2.45)	-1.01 (-1.61)	-0.86 (-1.49)	-0.88 (-1.32)	-0.56 (-0.99)	-0.72 (-1.47)
$\Delta State \times French LO$	-0.70 (-0.28)	-5.07 (-1.80)	-8.61 (-1.83)	-4.34 (-0.51)	6.05 (2.30)	1.63 (1.37)	1.02 (0.82)	1.61 (0.75)	-0.73 (-0.28)	12.96 (0.80)
<i>Mixed LO</i>						-0.29 (-0.57)	-0.15 (-0.31)	-0.12 (-0.24)	-0.01 (-0.02)	-0.28 (-0.60)
$\Delta State \times Mixed LO$						0.48 (0.47)	-0.04 (-0.03)	-0.26 (-0.16)	-1.55 (-0.68)	12.69 (0.89)
<i>German LO</i>	2.06 (0.77)	-8.30*** (-10.42)	-0.83 (-1.63)	-1.29 (-1.20)	-11.19 (-0.92)	-0.60 (-0.56)	-2.14** (-2.06)	-0.80 (-1.10)	-0.98 (-1.38)	-0.41 (-0.61)
$\Delta State \times German LO$	-4.03 (-0.79)	23.46*** (8.33)	40.04*** (6.44)	-53.50 (-1.02)	12.18 (0.91)	1.06 (0.55)	6.56** (2.10)	2.90 (0.66)	11.31* (1.93)	28.79 (1.28)
<i>Scandinavian LO</i>	-0.25 (-0.12)	2.15 (0.97)	1.16 (0.88)	0.08 (0.09)	0.72 (0.41)	0.20 (0.29)	0.49 (0.82)	-0.44 (-0.32)	-0.79 (-0.97)	-1.18* (-1.78)
$\Delta State \times Scandinav. LO$	0.53 (0.21)	-4.64 (-1.11)	-5.71 (-1.30)	-3.66 (-0.73)	-1.65 (-0.81)	-0.44 (-0.40)	-1.18 (-0.95)	0.26 (0.09)	2.44 (0.64)	40.93** (2.10)
R-squared	0.82	0.90	0.89	0.80	0.91	0.35	0.33	0.26	0.30	0.29
No. of obs.	17	17	17	17	17	50	50	50	50	50
Baseline controls	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES

Notes: The dependent variable is the change in the ration of stock market capitalization to GDP between 1913 and 1960 in columns (1) to (5). Stock market capitalization data for Mixed LO countries are not available. The dependent variable is the change in the ration of stock market capitalization to GDP between 1991 and 2007 in columns (6) to (10). Figures in parentheses indicate robust *t*-statistics. ***, ** and * denote significance at the 1, 5 and 10% levels, respectively.

Table 9: The quality and fragility of states

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Dep. Var. = <i>FinDev</i>	<i>State is interacted with democracy</i>	<i>State is interacted with Barro-Lee's political instability index (reverse coded)</i>	<i>State is interacted with Alesina et al.'s political instability (major changes) index (reverse coded)</i>	<i>State is interacted with Bank-Wilson's regime instability index (reverse coded)</i>	<i>State is interacted with Bank-Wilson's within regime instability index TWO (reverse coded)</i>	<i>State is interacted with Bank-Wilson's violence index (reverse coded)</i>	<i>State is interacted with Esteban et al.'s incidence of civil war index (reverse coded)</i>
<i>State</i>	0.089** (2.197)	0.474 (1.007)	1.092 (1.375)	0.534 (1.616)	0.503 (1.244)	0.553 (1.509)	0.099*** (2.754)
<i>French LO</i>	-0.167 (-1.324)	-0.088 (-0.440)	-0.064 (-0.299)	-0.179 (-0.978)	-0.169 (-0.819)	-0.219 (-1.066)	-0.131 (-0.793)
<i>State x French LO</i>	-0.024 (-0.583)	-0.370 (-0.852)	-0.744 (-0.954)	-0.104 (-0.313)	-0.130 (-0.301)	0.003 (0.009)	-0.052 (-1.335)
<i>Mixed LO</i>	0.090 (0.378)	0.182 (0.599)	0.257 (0.905)	0.321 (1.076)	0.383 (1.206)	0.003 (0.011)	0.244 (0.928)
<i>State x Mixed LO</i>	0.010 (0.153)	-0.066 (-0.094)	-0.520 (-0.463)	-0.497 (-0.753)	-0.870 (-1.128)	0.563 (0.931)	-0.020 (-0.302)
<i>German LO</i>	-0.184 (-0.485)	-3.258*** (-5.279)	-2.983*** (-2.700)	-0.899*** (-3.021)	-0.571 (-1.584)	-0.946*** (-3.019)	-1.098*** (-3.197)
<i>State x German LO</i>	-0.011 (-0.170)	3.795*** (4.420)	5.849** (2.293)	1.028** (2.166)	0.666 (1.055)	1.032** (2.068)	0.097* (1.800)
<i>Scandinavian LO</i>	-0.986*** (-2.659)	-1.351*** (-2.929)	-1.277*** (-3.113)	-0.975*** (-2.727)	-1.017*** (-3.306)	-0.947** (-2.486)	-0.775* (-1.926)
<i>State x Scandinavian L</i>	0.147** (2.288)	1.539** (2.067)	2.315* (1.986)	1.337*** (2.798)	1.709*** (3.625)	1.383** (2.355)	0.092 (1.467)
R-squared	0.525	0.677	0.685	0.589	0.552	0.608	0.589
No. of obs.	125	101	99	121	121	122	121
Baseline controls	YES	YES	YES	YES	YES	YES	YES

Notes: The dependent variable is average private credit as a share of GDP year 2000-2009. Figures in the parentheses indicate standard errors. ***, ** and * denote significance at the 1, 5 and 10% levels, respectively. All control variables used in the last column of Table 2 (our benchmark model) are included in the regressions but they are not reported to conserve space.

Table 10: Effects on financial integration

Dep. Var. =	(1) Capital account openness index of Quinn et al. (2011)	(2) International capital flow openness index of Abiad et al. (2010)	(3) Overall financial reform index of Abiad et al. (2010)
<i>State</i>	0.093 (0.452)	-1.571 (-1.602)	-0.296 (-1.186)
<i>French LO</i>	-0.043 (-0.349)	-0.859* (-1.863)	-0.175 (-1.466)
<i>State x French LO</i>	-0.100 (-0.454)	1.378 (1.383)	0.191 (0.764)
<i>Mixed LO</i>	0.129 (0.868)	-0.827 (-1.214)	-0.038 (-0.268)
<i>State x Mixed LO</i>	-0.402 (-1.554)	1.119 (0.877)	0.086 (0.313)
<i>German LO</i>	-0.407 (-1.025)	-0.440 (-0.641)	-0.055 (-0.314)
<i>State x German LO</i>	0.425 (0.789)	0.820 (0.656)	0.076 (0.236)
<i>Scandinavian LO</i>	-0.612** (-2.386)	-1.445** (-2.519)	-0.504*** (-3.820)
<i>State x Scandinav. LO</i>	0.693* (1.875)	1.834* (1.742)	0.601** (2.447)
R-squared	0.533	0.511	0.632
No. of obs.	87	83	83
Baseline controls	YES	YES	YES

Notes: Figures in the parentheses indicate standard errors. ***, ** and * denote significance at the 1, 5 and 10% levels, respectively. All control variables used in the last column of Table 2 (our benchmark model) are included in the regressions but they are not reported to conserve space.

Table 11: Effects on financial crisis

	(1)	(2)	(3)	(4)
Dep. Var. = cumulative occurrence of financial crises	Early crises (1800-1900)	Later crises (1901-2006)	Recent crises (1950-2006)	Whole period (1800-2006)
<i>State</i> ¹⁻¹⁸⁰⁰	1.37 (0.47)			-0.90 (-0.15)
<i>State</i> ¹⁻¹⁹⁰⁰		-2.12 (-0.49)		
<i>State</i> ¹⁻¹⁹⁵⁰			-1.94 (-0.56)	
<i>French LO</i>	-1.16 (-0.88)	-2.81 (-1.24)	-1.69 (-0.79)	-3.94 (-1.34)
<i>State</i> ¹⁻¹⁸⁰⁰ <i>x</i> <i>French LO</i>	-0.03 (-0.01)			3.40 (0.52)
<i>State</i> ¹⁻¹⁹⁰⁰ <i>x</i> <i>French LO</i>		3.49 (0.68)		
<i>State</i> ¹⁻¹⁹⁵⁰ <i>x</i> <i>French LO</i>			1.72 (0.42)	
<i>Mixed LO</i>	1.70 (0.77)	-3.33 (-0.93)	-3.62 (-1.06)	-1.21 (-0.27)
<i>State</i> ¹⁻¹⁸⁰⁰ <i>x</i> <i>Mixed LO</i>	-4.86 (-1.15)			0.06 (0.01)
<i>State</i> ¹⁻¹⁹⁰⁰ <i>x</i> <i>Mixed LO</i>		6.22 (0.68)		
<i>State</i> ¹⁻¹⁹⁵⁰ <i>x</i> <i>Mixed LO</i>			8.68 (1.12)	
<i>German LO</i>	-7.96 ^{***} (-3.43)	-11.48 ^{**} (-2.61)	-6.06 [*] (-1.90)	-19.06 ^{***} (-3.28)
<i>State</i> ¹⁻¹⁸⁰⁰ <i>x</i> <i>German LO</i>	8.13 ^{**} (2.19)			27.34 ^{***} (2.82)
<i>State</i> ¹⁻¹⁹⁰⁰ <i>x</i> <i>German LO</i>		20.62 ^{***} (2.73)		
<i>State</i> ¹⁻¹⁹⁵⁰ <i>x</i> <i>German LO</i>			10.06 ^{**} (2.02)	
<i>Scandinavian LO</i>	-7.42 ^{**} (-2.48)	-4.20 (-1.26)	-2.47 (-0.93)	-11.28 ^{**} (-2.13)
<i>State</i> ¹⁻¹⁸⁰⁰ <i>x</i> <i>Scand. LO</i>	10.74 [*] (1.78)			23.59 ^{**} (2.25)
<i>State</i> ¹⁻¹⁹⁰⁰ <i>x</i> <i>Scand. LO</i>		13.70 ^{**} (2.15)		
<i>State</i> ¹⁻¹⁹⁵⁰ <i>x</i> <i>Scand. LO</i>			6.90 (1.61)	
R-squared	0.389	0.240	0.200	0.301
No. of obs.	127	127	127	127
Baseline controls	YES	YES	YES	YES

Notes: Figures in the parentheses indicate standard errors. ***, ** and * denote significance at the 1, 5 and 10% levels, respectively. All control variables used in the last column of Table 2 (our benchmark model) are included in the regressions but they are not reported to conserve space.

Figure 1: Distribution of state antiquity for 151 countries (1 AD to 1950 AD)

Notes: The diagram above shows the state antiquity data for all available countries in the original data set. A higher value indicates the presence of a longer state history. Source: Putterman (2004).

Figure 2: The Distribution of Statehood Experience across Legal Origins

Notes: The diagram includes only data for the 127 countries used in the estimations.

APPENDIX I: DATA

Table A1: Definition of variables and data sources

Variable	Description	Source
[A] Outcome variables (financial development)		
<i>Domestic credit to private sector / GDP</i>	Total financial resources provided to the private sector (such as through loans, purchases of non-equity securities, and trade credits and other accounts receivable, that establish a claim for repayment) as a percentage of GDP, average over 2000-2009.	Beck and Demirgüç-Kunt (2009)
<i>Deposit money bank assets / GDP</i>	Deposit money bank claims on domestic non-financial real sector as a ratio of GDP, averaged over 2000-2009.	Beck and Demirgüç-Kunt (2009)
<i>Private credit by deposit money banks / GDP</i>	The financial resources provided to the private sector by deposit money banks (including commercial banks and other financial institutions that accept transferable deposits) as a share of GDP, averaged over 2000-2009.	Beck and Demirgüç-Kunt (2009)
<i>Household credit / GDP</i>	Total claims of deposit money banks on households as ratio to GDP, averaged over 1994-2005.	Beck et al. (2012)
<i>Credit dependence ratio</i>	A proxy for the extent of incumbents' support for financial development. The data are constructed using industrial sectors' dependence on credit (expressed as a percentage of capital expenditures) where a high value implies low incentives to block financial development.	Becerra et al. (2012)
<i>Stock market turnover ratio</i>	The value of total shares traded divided by stock market capitalization, averaged over 2000-2009.	Beck and Demirgüç-Kunt (2009)
<i>Stock market total value traded / GDP</i>	Total shares traded on the stock market exchange as a ratio of GDP, average over 2000-2009.	Beck and Demirgüç-Kunt (2009)
<i>Stock market capitalization ratio</i>	Total value of listed shares to GDP. The historical data from 1913 to 1960 are obtained from Rajan and Zingales (2003), and from Beck and Demirgüç-Kunt (2009) for 1991 to 2007.	Beck and Demirgüç-Kunt (2009); Rajan and Zingales (2003)
[B] Main explanatory variables		
<i>State</i>	An index of state history covering the period from 1 AD to 1950 AD, scaled to take values between 0 and 1. The latest version, v3.1, is used. In the robustness checks, several alternative periods using the following cut-offs are also considered: 500 AD, 1000 AD, 1500 AD and 1750 AD. An extended state history covering the period from 3500 BC to 1500 AD is used in the robustness checks. In this case, a decay rate of 1% is assumed. The variable is scaled to take values between 0 and 1.	Putterman (2004); Borcan et al. (2014)
<i>No. of surrounding old states</i>	The number of countries, which share a common border with the country under consideration, that has a state value above the 75 th percentile of the state values.	Contiguity data are obtained from Mayer (2011)
<i>British LO</i> <i>French LO</i> <i>Mixed LO</i> <i>German LO</i>	A dummy variable that identifies the legal tradition of the company law or commercial code of each country as British, French, Mixed or Scandinavian. An alternative classification that excludes the "Mixed" category, by La	Klerman et al. (2011); La Porta et al. (2008)

<i>Scandinavian LO</i>	Porta et al. (2008), is used in the robustness checks. In the estimations, <i>British LO</i> is the excluded group.	
[C] Geographic controls		
<i>Island</i>	A dummy variable that equals 1 if a country is an island and 0 otherwise.	CIA World Fact Book
<i>Landlocked</i>	A dummy variable that equals 1 if a country is fully enclosed by land and 0 otherwise.	CIA World Fact Book
<i>Latitude</i>	Value of absolute latitude of each country.	CIA World Fact Book
<i>Distance to coast</i>	The mean distance of a country to the nearest coastline or sea-navigable river (in km)	Gallup et al. (2010)
<i>Mean elevation</i>	The mean elevation of a country above sea level (in km).	G-ECON Project
<i>Precipitation</i>	The average monthly precipitation of a country over the period 1961-1990 (in mm).	G-ECON Project
<i>Terrain ruggedness</i>	An index that quantifies small-scale terrain irregularities in each country.	Nunn and Puga (2012)
[D] Instruments		
<i>Years since agricultural transition</i>	The number of years elapsed, in 2000 AD, since the transition to agriculture was estimated to occur (in thousand years).	Putterman (2006)
<i>Geographical proximity to the regional frontier</i>	<p>The ‘Haversine’ distance between the central points of a particular country and a regional leader based on their present territories. The ‘Haversine’ formula calculates the shortest distances between two points on the surface of a sphere from their longitudes and latitudes. It is measured as $1 - (Geog. Dist._{i,RF} / Geog. Dist._{Max})$ where $Geog. Dist._{i,RF}$ is the geographical distance between country i and its regional frontier RF and $Geog. Dist._{Max}$ is the maximum distance in the sample. The frontiers in 1000 BC are chosen based on the size of the cities. The number of frontiers in each region is set to be two, but in cases where the second frontier cannot be identified only one frontier has been chosen.</p> <p>Specifically, the frontiers chosen in each continent for 1000 BC are Egypt (Thebes, Memphis) for Africa, Mexico (Olmec civilization) and Peru (Chavín civilization) for America, China (Xi’an, Luoyang) and Iraq (Babylon) for Asia, Greece (Mycenaean civilization) for Europe, and Australia for Oceania.</p>	CIA World Fact Book for longitudes and latitudes; Chandler (1987), Modelski (2003), Morris (2010) and TimeMaps (2013) for size of urban settlements; World Mapper for population density.
<i>Technology adoption in 1 AD and 1000 BC</i>	The average values of the adoption levels of technology in 1 AD and 1000 BC. It covers the following sectors: agriculture, transportation, communications, industry and military.	Comin et al. (2010)
[E] Other control variables		
<i>Creditor rights</i>	An index reflecting the extent of credit power of secured lenders in the event of bankruptcy, scaled to take values between 0 and 1	Djankov et al. (2007)
<i>Contract enforcement</i>	The number of days to resolve a payment dispute through courts, scaled to take values between 0 and 1	Djankov et al. (2007)

<i>Information sharing</i>	A dummy variable that signifies the presence of either a public registry or a private bureau which facilitates the dissemination of credit information of borrowers among financial intermediaries	Djankov et al. (2007)
<i>Religious composition</i>	The percentages of the population of each country that belonged to Catholic, Protestant, Muslim or other religions in 1900	McCleary and Barro (2006)
<i>Colonial origin</i>	Dummy variables that distinguish British, French, Portuguese, Spanish, and other European (Dutch, Belgian, and Italian) colonial origin for countries colonized since 1700.	Nunn and Puga (2012)
<i>Historical pathogen prevalence</i>	The average prevalence ratings of the following seven diseases: leishmanias, schistosomes, trypanosomes, malaria, typhus, filariae, and dengue.	Murray and Schaller (2010)
<i>Institutional quality</i>	The averaged ranking score in 2000 of the following World Bank's Worldwide Governance Indicators: voice and accountability, political stability, rule of law, control for corruption, regulatory quality and government effectiveness (scaled to 0 and 1).	Kaufmann et al. (2010)
<i>Democracy</i>	Average scores of the Polity IV democracy index from 1991-2000. The index considers three elements, namely the freedom to elect political leaders, the existence of constraints on executives' power, and civil liberties.	Marshall and Jaggers (2010)
<i>Trade openness</i>	The sum of exports and imports of goods and services as a share of GDP in 2000.	World Development Indicators (2015)
<i>Per capita income</i>	GDP per capita in 2000 converted to constant 2005 international dollars using PPP rates [on logs scale].	World Development Indicators (2015)
<i>Pronoun drop</i>	A dummy variable indicating whether the language allows the personal pronoun to be dropped where one indicates "allow" and zero otherwise.	Kashima and Kashima (1998)
[F] Financial integration and financial crisis measures		
<i>Capital account openness</i>	The average capital account openness for the period 1950–2004. The data are scaled to 0-1, with 1 representing an economy fully open to capital flows.	Quinn et al. (2011)
<i>International capital flows</i>	The average international capital flows for the period 1973-2005. The original index is measured on a scale of 0-3, with 3 representing an economy with the most international capital flows.	Abiad et al. (2010)
<i>Financial sector reforms</i>	An average composite index of financial reform from 1973 to 2005. It is constructed by considering deregulation of entry barriers, banking supervision, privatization in the banking sector, openness to international capital flows, and security market reforms. For each dimension a value of 0, 1, 2 or 3 is assigned and the sum of the values for all policy variables reflects the extent of financial deregulation.	Abiad et al. (2010)
<i>Financial crisis</i>	A dummy variable that records the dates of historical banking crises from 1800-2006. A banking crisis is marked by two types of events: (i) bank runs that lead to the closure, merging, or takeover by the public sector of one or more financial institutions; or (ii) if there are no	Reinhart and Rogoff (2011)

runs, the closure, merging, takeover, or large-scale government assistance of an important financial institution (or group of institutions) that marks the start of a string of similar outcomes for other financial institutions. A value of 1 is assigned if a crisis is deemed to have occurred in a particular year.

[G] Political risk variables

Barro-Lee's (1994) political instability index	The index is formulated by 0.5 times the number of assassination per million population per year plus 0.5 time the number of revolution per year. The data on assassinations and revolutions come from Banks (1979). The variable is reverse coded so that a higher value reflects lower political instability.	Barro and Lee (1994)
Alesina et al.'s (1996) political instability (major changes) index	The index is based on major changes data compiled by Banks (1979) and Jodice and Taylor (1983). The variable is reverse coded so that higher values reflect lower political instability.	Alesina et al. (1996)
Bank-Wilson's (2017) regime instability index	Following the method proposed by Aisen and Veiga (2013), the index is obtained by taking the first principal component of constitutional changes, coups and cabinets changes. The original data are from Cross-national Time Series data archive. The variable is reverse coded so that higher values reflect lower political instability.	Banks and Wilson (2017)
Bank-Wilson's (2017) within regime instability index TWO	Following the method proposed by Aisen and Veiga (2013), the index is obtained by taking the first principal component of the number of legislative changes, fractionalization index, government crisis, executive changes and cabinet changes. The original data are from Cross-national Time Series data archive. The variable is reverse coded so that higher values reflect lower political instability.	Banks and Wilson (2017)
Bank-Wilson's (2017) violence index	Following the method proposed by Aisen and Veiga (2013), the index is obtained by taking the first principal component of assassinations and revolutions. The original data are from Cross-national Time Series data archive. The variable is reverse coded so that higher values reflect lower political instability.	Banks and Wilson (2017)
Esteban et al.'s (2012) incidence of civil war index	The index captures the extent to which internal armed conflict in which (at least) between 25 and 999 battle-related deaths occurred over the period 1960-2008 (labelled "PRIOcwA" in the dataset). The variable is reverse coded so that higher values reflect lower political instability.	Esteban et al. (2012)

Table A2: List of countries and their state history (by legal tradition)

[a] French LO	State				
Albania	0.572	Mexico	0.593	Japan	0.884
Algeria	0.599	Moldova	0.377	Korea, Rep.	0.915
Angola	0.304	Morocco	0.829	Latvia	0.321
Argentina	0.245	Mozambique	0.231	Mongolia	0.520
Armenia	0.537	Netherlands	0.749	Poland	0.593
Belgium	0.741	Niger	0.406	Slovak Republic	0.400
Benin	0.192	Panama	0.258	Slovenia	0.505
Bolivia	0.684	Paraguay	0.270	Switzerland	0.810
Brazil	0.269	Peru	0.632	[d] Scandinavian LO	State
Burkina Faso	0.326	Portugal	0.810	Denmark	0.771
Burundi	0.210	Romania	0.462	Finland	0.340
Cambodia	0.843	Russia	0.456	Iceland	0.450
Cameroon	0.438	Rwanda	0.352	Norway	0.574
Cape Verde	0.227	Senegal	0.460	Sweden	0.591
Central African Republic	0.028	Spain	0.745	[e] British LO	State
Chad	0.243	Swaziland	0.138	Australia	0.147
Chile	0.289	Syria	0.571	Bangladesh	0.520
Colombia	0.274	Togo	0.084	Canada	0.194
Congo, Rep.	0.259	Tunisia	0.732	Fiji	0.042
Costa Rica	0.259	Turkey	0.887	Gambia	0.261
Cote d'Ivoire	0.294	Uruguay	0.193	Ghana	0.394
Dominican Republic	0.263	Venezuela	0.270	Hong Kong	0.891
Ecuador	0.331	Vietnam	0.677	India	0.698
Egypt	0.695	[b] Mixed LO	State	Ireland	0.547
El Salvador	0.266	Botswana	0.341	Jamaica	0.209
Ethiopia	0.964	Cyprus	0.570	Kenya	0.028
France	0.839	Guyana	0.170	Malawi	0.333
Gabon	0.055	Israel	0.501	Malaysia	0.574
Greece	0.574	Jordan	0.504	Nepal	0.850
Guatemala	0.505	Lesotho	0.091	New Zealand	0.069
Haiti	0.289	Mauritius	0.118	Nigeria	0.553
Honduras	0.325	Philippines	0.235	Pakistan	0.783
Indonesia	0.579	South Africa	0.136	Papua New Guinea	0.021
Iran	0.813	Sri Lanka	0.748	Sierra Leone	0.049
Italy	0.690	Thailand	0.729	Singapore	0.357
Kazakhstan	0.396	[c] German LO	State	Sudan	0.682
Kyrgyzstan	0.295	Austria	0.831	Trinidad and Tobago	0.170
Laos	0.644	Bulgaria	0.652	Uganda	0.271
Libya	0.616	China	0.938	United Kingdom	0.788
Lithuania	0.455	Croatia	0.595	United States	0.210
Macedonia	0.486	Czech Republic	0.601	Zambia	0.106
Madagascar	0.299	Estonia	0.290	[e] Islamic LO	State
Mali	0.484	Georgia	0.553	Yemen	0.592
Mauritania	0.414	Germany	0.776		
		Hungary	0.592		

Notes: The estimations include up to 127 countries listed in the table above. Figures in the table indicate statehood experience accumulated over the period 1-1950AD.

Appendix II: Construction of State Antiquity (*State*)

The state antiquity index of Putterman (2004) includes 39 periods of 50 years spanning from 1 to 1950 AD. It consists of the following three components:

$ST^{PRESENCE}$: Is there a government above the tribal level?
[*Yes* = 1; *No* = 0]

$ST^{AUTONOMY}$: Is this government foreign or locally based?
[*Local* = 1; *In between* = 0.75; *Foreign* = 0.5]

$ST^{COVERAGE}$: How much of the territory of the modern country was ruled by this government?
[>50% = 1; 25–50% = 0.75; 10–25% = 0.5; <10% = 0.3]

The extent of state presence (SA_t) in any particular 50 years period (t) is measured as the product of the scores on these components and 50. Consequently, a score of 0 indicates no presence of state, 25 reflects that a country has a supra-tribal authority but its entire territory is ruled by a foreign authority, and 50 indicates the presence of an autonomous nation, and so on.

$$SA_t = ST^{PRESENCE} \times ST^{AUTONOMY} \times ST^{COVERAGE} \times 50 \quad (A1)$$

$$0 \leq SA_t \leq 50, t = 1, 2, \dots, 39$$

The length of state history, or state antiquity (*State*), is measured as the cumulative presence of state by combining data over the entire 39 periods. A 5 percent discount rate is applied to allow for the fact that states formed in the more distant past have relatively less influence on today's economic conditions. To ease interpretation, the series is scaled into 0 and 1 using its maximum possible value. Accordingly, state history for a particular country over the last two millennia (1 – 1950 AD) is calculated as follows:

$$State = \frac{\sum_{t=1}^{39} (1.05)^{1-t} \cdot SA_t}{\sum_{t=1}^{39} (1.05)^{1-t} \cdot 50}, \quad 0 \leq State \leq 1 \quad (A2)$$

Appendix III: Additional Results

III.A Are the results sensitive to the use of alternative measures of statehood experience and legal tradition?

In Table A3, we report results using other measures of statehood experience and legal tradition. In columns (1) and (2), *State* is measured with zero and 15 percent depreciation rates, respectively. This is a check whether the estimates are sensitive to use of different decay rates for the accumulation of state experience (the default measure used a 5 percent depreciation rate). We cannot rule out the possibility that the results are largely driven by states that were formed only in the last two millennia. We allow for this possibility by using a more complete series of state experience from Borcan et al. (2014), who provide data on state experience from 3500 BC to 1500 AD in column (3).

Table A3: Using alternative measures for statehood and legal tradition

	(1)	(2)	(3)	(4)	(5)
	Depreciation rate for <i>State</i> = 0%	Depreciation rate for <i>State</i> = 15%	Using statehood data for five millennia	Using no. of surrounding old states	<i>LO</i> is based on La Porta et. al. (2008)'s classification
<i>State</i>	0.390 (0.981)	0.658* (1.804)	0.038 (0.070)	-0.394 (-0.772)	0.394 (1.148)
<i>French LO</i>	-0.255 (-1.311)	-0.196 (-0.805)	-0.304* (-1.938)	-0.960*** (-2.706)	-0.267 (-1.408)
<i>State x French LO</i>	-0.069 (-0.175)	-0.199 (-0.495)	0.185 (0.345)	0.539 (1.036)	-0.103 (-0.284)
<i>Mixed LO</i>	0.135 (0.492)	0.126 (0.354)	0.006 (0.025)	0.183 (0.524)	
<i>State x Mixed LO</i>	0.049 (0.073)	0.103 (0.170)	0.601 (0.826)	-0.385 (-0.698)	
<i>German LO</i>	-1.038** (-3.394)	-1.431*** (-3.913)	-0.828*** (-3.618)	-0.829** (-2.454)	-1.287*** (-3.972)
<i>State x German LO</i>	1.394*** (2.731)	1.572*** (2.994)	2.404*** (3.170)	0.502 (0.984)	1.509*** (3.067)
<i>Scandinavian LO</i>	-0.754* (-1.953)	-1.197** (-2.492)	-0.519 (-1.610)	-0.553* (-1.796)	-1.072*** (-2.939)
<i>State x Scandinav. LO</i>	1.710** (2.049)	1.296* (1.914)	3.427 (1.425)	1.118** (2.222)	1.602*** (2.811)
<i>Constant</i>	0.053 (0.220)	-0.106 (-0.415)	0.162 (0.684)	1.186** (2.452)	0.103 (0.454)
R-squared	0.551	0.574	0.508	0.617	0.549
No. of obs.	127	127	127	74	127
Baseline controls	YES	YES	YES	YES	YES

Notes: Figures in the parentheses indicate standard errors. ***, ** and * denote significance at the 1, 5 and 10% levels, respectively. All control variables used in the last column of Table 2 (our benchmark model) are included in the regressions but they are not reported to conserve space.

A country's ability to accumulate state experience may also be derived from the degree to which it is surrounded by countries with extended state experience, assuming that geographic proximity facilitates the diffusion of state knowledge. To provide an alternative measure for *State*, we consider how many countries that share a common border with the country under consideration have extensive statehood experience in column (4). As a cut-off value for being classified as an old and experienced state, we utilize a *State* value larger than the 75th percentile country out of all countries included in the sample.

Finally, in the last column of the table the legal tradition of company law or the commercial code for each country is classified using the approach of La Porta et al.'s (2008), which does not include a classification for mixed legal origins.

Columns (1) and (2) show that the results are unlikely to be driven by the use of different depreciation rates for *State* ranging from zero to 15 percent. When statehood data for five millennia are used, the results reported in column (3) **show that our basic findings are consistent with the baseline results**, although in this case only the coefficients of *German LO* and *State x German LO* are significant. When we use the number of surrounding old states to measure state experience in column (4), the results are still consistent. The results therefore also imply that the diffusion of state experience from neighboring countries is an important source of domestic statehood experience accumulation. Finally, the results are very similar when we use La Porta et al.'s (2008) classification for legal tradition (column (5)).

III.B Sub-periods of state development

This subsection performs some additional empirical investigations by considering statehood experience accumulated over different sub-periods. The results are reported in Table A4. First, the following earlier statehood periods are considered: 1-500 AD (column (1)), 1-1000 AD (column (2)), 1-1500 AD (column (3)), and 1-1750 AD (column (4)). Interestingly, we note that the magnitude of the coefficients of *State x German LO* increases by nearly 40% as the measure for statehood experience is increased from five centuries (column (1)) to nearly eighteen centuries (column (4)) since 1 AD. The coefficients remain statistically significant throughout. In the case of *State x Scandinavian LO*, its coefficient is only significant when statehood experience over the period 1-1750 AD is considered. These findings seem to suggest that the

length of statehood matters whereby an older state is equipped with greater capacity to improve adaptable legal systems.

Table A4: Sub-periods of statehood experience

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Dep. Var. = <i>FinDev</i>	<i>State</i> is from 1- 500 AD	<i>State</i> is from 1- 1000 AD	<i>State</i> is from 1- 1500 AD	<i>State</i> is from 1- 1750AD	<i>State</i> is from 501-1950 AD	<i>State</i> is from 1001- 1950 AD	<i>State</i> is from 1501- 1950 AD	<i>State</i> is from 1751- 1950 AD
<i>State</i>	0.131 (0.366)	0.256 (0.730)	0.279 (0.831)	0.292 (0.773)	0.464 (1.249)	0.472 (1.286)	0.513 (1.543)	1.085*** (3.038)
<i>French LO</i>	-0.289** (-2.131)	-0.266* (-1.729)	-0.251 (-1.476)	-0.274 (-1.345)	-0.244 (-1.086)	-0.238 (-0.995)	-0.237 (-0.943)	0.054 (0.204)
<i>State x French LO</i>	0.048 (0.133)	-0.033 (-0.095)	-0.062 (-0.182)	-0.016 (-0.041)	-0.092 (-0.236)	-0.101 (-0.257)	-0.115 (-0.298)	-0.597 (-1.334)
<i>Mixed LO</i>	0.138 (0.716)	0.144 (0.676)	0.105 (0.447)	0.101 (0.361)	0.095 (0.292)	0.064 (0.184)	0.181 (0.507)	0.353 (1.062)
<i>State x Mixed LO</i>	-0.080 (-0.165)	-0.023 (-0.042)	0.093 (0.164)	0.137 (0.220)	0.163 (0.258)	0.212 (0.337)	-0.028 (-0.052)	-0.332 (-0.643)
<i>German LO</i>	-0.572*** (-3.134)	-0.663*** (-2.951)	-0.916*** (-3.258)	-1.186*** (-3.574)	-1.265*** (-3.572)	-1.371*** (-3.493)	-1.471*** (-4.286)	-1.110*** (-3.209)
<i>State x German LO</i>	1.074** (2.526)	1.041* (2.424)	1.132** (2.456)	1.488*** (2.845)	1.441*** (2.727)	1.464** (2.578)	1.635*** (3.425)	1.117** (2.190)
<i>Scandinavian LO</i>	-0.084 (-0.333)	-0.188 (-0.709)	-0.462 (-1.341)	-0.806** (-2.281)	-0.962** (-2.369)	-1.086** (-2.581)	-1.036* (-1.719)	-1.055 (-1.073)
<i>State x Scandinav. LO</i>		1.346 (0.972)	0.967 (1.147)	1.439** (2.332)	1.288* (2.209)	1.201** (2.104)	1.011 (1.244)	0.848 (0.701)
R-squared	0.508	0.533	0.520	0.542	0.555	0.546	0.568	0.603
No. of obs.	127	127	127	127	127	127	127	127
Baseline controls	YES	YES	YES	YES	YES	YES	YES	YES

Notes: The dependent variable is average private credit as a share of GDP year 2000-2009. Figures in the parentheses indicate robust *t*-statistics. ***, ** and * denote significance at the 1, 5 and 10% levels, respectively.

Next, we turn to considering statehood experience accumulated more recently by using the following statehood periods: 501-1950 AD (column (5)), 1001-1950 AD (column (6)), 1501-1950 AD (column (7)), and 1751-1950 AD (column (8)). In this case, the coefficients of the two interaction terms of interest are both statistically significant when at least one millennium of statehood experience is considered (columns (5) and (6)). Only the coefficients of *State x German LO* are statistically significant when shorter durations of statehood experiences since 1501 AD and 1750 AD are considered (columns (7) and (8), respectively). Hence, the evidence here also suggests that countries with more state experience have greater capacity to improve their adaptable legal systems.

Note that unlike the baseline estimates, the coefficients for *State x Scandinavian LO*

are insignificant in columns (3) and (7) when the sub-periods 1-1500 AD and 1501-1950 AD of statehood experience are considered, respectively. This does not necessarily invalidate our previous finding, but rather suggests that a longer statehood (1-1950 AD) is more relevant for flexible legal systems to adapt to their local needs.

III.C Heterogeneous effects of state experience

The statehood experience measure used in this paper is obtained by multiplying three sub-indices: state presence, state autonomy and state coverage. State presence considers whether a government above the tribal level was present, state autonomy captures whether this government was foreign or locally based, and state coverage measures the extent to which the territory of the modern country was ruled by this government (see Appendix II for more details). The availability of this disaggregated information allows us to explore how financial development responds to different components of statehood experience.

Table A5: Components of statehood experience

	(1)	(2)	(3)	(4)
Dep. Var. = <i>FinDev</i>	Existence of <i>State</i>	Autonomy of <i>State</i>	Coverage of <i>State</i>	1 st PCA of Existence, Autonomy and Coverage of <i>State</i>
<i>State</i>	0.262 (0.814)	0.280 (0.850)	0.374 (0.991)	0.193 (0.958)
<i>French LO</i>	-0.183 (-0.744)	-0.274 (-1.184)	-0.169 (-0.718)	-0.206 (-0.851)
<i>State x French LO</i>	-0.139 (-0.425)	-0.015 (-0.043)	-0.183 (-0.511)	-0.073 (-0.357)
<i>Mixed LO</i>	0.026 (0.070)	0.141 (0.434)	0.021 (0.057)	0.053 (0.142)
<i>State x Mixed LO</i>	0.139 (0.283)	0.008 (0.013)	0.150 (0.290)	0.081 (0.250)
<i>German LO</i>	-1.656 ^{***} (-2.936)	-1.261 ^{***} (-3.722)	-1.529 ^{**} (-2.528)	-1.773 ^{***} (-3.370)
<i>State x German LO</i>	1.637 ^{**} (2.375)	1.469 ^{***} (3.115)	1.545 [*] (1.940)	1.108 ^{***} (2.924)
<i>Scandinavian LO</i>	-1.323 (-1.314)	-0.937 ^{**} (-2.301)	-1.221 (-1.011)	-1.308 [*] (-1.784)
<i>State x Scandinav. LO</i>	1.774 (1.205)	1.422 [*] (2.441)	1.666 (0.895)	1.066 [*] (1.674)
R-squared	0.502	0.548	0.494	0.528
No. of obs.	127	127	127	127
Baseline controls	YES	YES	YES	YES

Notes: The dependent variable is average private credit as a share of GDP year 2000-2009. Figures in the parentheses indicate robust *t*-statistics. ***, ** and * denote significance at the 1, 5 and 10% levels, respectively.

The results reported in Table A5 indicate that certain dimensions of statehood experience are relatively more relevant. In particular, the coefficients of both *State x German LO* and *State x Scandinavian LO* are significant only when state autonomy is considered (columns (2)). Only the coefficients of *State x German LO* are significant when state existence and state coverage are used (columns (1) and (3), respectively). These results therefore imply that a locally-based government has a greater susceptibility and incentive to improve its legal system with increased accumulated state experience, provided the system is adaptable. Finally, we also take the first principal component of these three dimensions of state and report the results in column (4). The results support our earlier findings.